

ADCARE HEALTH SYSTEMS, INC

Form 10-Q/A

October 22, 2013

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# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Amendment No. 2 on

## FORM 10-Q/A

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2012

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 001-33135

**AdCare Health Systems, Inc.**

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(Exact name of registrant as specified in its charter)

**Ohio**  
(State or Other Jurisdiction)

**31-1332119**  
(IRS Employer Identification Number)

of Incorporation)

**1145 Hembree Road, Roswell, GA 30076**

(Address of principal executive offices)

**(678) 869-5116**

(Registrant's telephone number)

**5057 Troy Rd, Springfield, OH 45502-9032**

(Former name, former address, or former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer   
(Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

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Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

As of April 30, 2012: 13,320,013 shares of common stock with no par value were outstanding.

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**EXPLANATORY NOTE**

This Amendment No. 2 on Form 10-Q/A (this Amendment No. 2) of AdCare Health Systems, Inc. and subsidiaries (collectively, the Company or we) amends the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2012, originally filed with the Securities and Exchange Commission (the Commission) on May 10, 2012 (the Original Filing Date), as amended by Amendment No. 1 thereto (Amendment No. 1) filed with the Commission on July 8, 2013 (as so amended by Amendment No. 1, the Original Report). This Amendment No. 2 amends the Original Report to revise Note 9, *Notes Payable and Other Debt*, to the unaudited consolidated financial statements included therein and Item 2., *Management's Discussion and Analysis of Financial Condition and Results of Operations*, to include certain disclosure regarding debt covenant compliance.

This Amendment No. 2 also includes as exhibits certifications from the Company's Chief Executive Officer and Chief Financial Officer dated as of the date of filing of this Amendment No. 2. Except as described above, no other portions of the Original Filing have been revised by this Amendment No. 2.

The Original Report continues to speak as of the Original Filing Date, and the Company has not updated disclosures contained therein to reflect information or events that have occurred since the Original Filing Date, except to reflect the revisions set forth in Amendment No. 1 and as discussed above. Accordingly, this Amendment No. 2 should be read in conjunction with the Company's other filings made with the Commission subsequent to the Original Filing Date, including any amendments to those filings.

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**AdCare Health Systems, Inc.**

**Form 10-Q/A**

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## Item 1. Financial Statements

**ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES**

## CONSOLIDATED BALANCE SHEETS

*(Amounts in 000 \$)*

	<b>March 31, 2012 Restated (Note 2) (Unaudited)</b>	<b>December 31, 2011</b>
<b><u>ASSETS</u></b>		
Current Assets:		
Cash and cash equivalents	\$ 11,000	\$ 7,364
Restricted cash and investments	1,208	1,883
Accounts receivable, net of allowance of \$2,081 and \$1,346	20,116	18,782
Prepaid expenses and other	827	663
Assets of disposal group held for sale	42	47
Total current assets	33,193	28,739
Restricted cash and investments	4,980	4,870
Property and equipment, net	102,703	102,449
Intangible assets - bed licenses	2,377	1,189
Intangible assets - lease rights, net	8,193	8,460
Goodwill	2,565	3,600
Escrow deposits for acquisitions	3,604	3,172
Lease deposits	1,685	1,685
Deferred loan costs, net	4,301	4,818
Other assets	72	122
Total assets	\$ 163,673	\$ 159,104
<b><u>LIABILITIES AND STOCKHOLDERS' EQUITY</u></b>		
Current Liabilities:		
Current portion of notes payable and other debt	\$ 7,462	\$ 4,567
Revolving credit facilities and lines of credit	8,095	7,343
Accounts payable	13,998	12,075
Accrued expenses	11,565	9,881
Liabilities of disposal group held for sale	192	240
Total current liabilities	41,312	34,106
Notes payable and other debt, net of current portion:		
Senior debt, net of discounts	84,824	87,771
Convertible debt, net of discounts	14,824	14,614
Revolving credit facilities		1,308
Other debt	1,150	1,400

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Derivative liability	1,479	1,889
Other liabilities	2,119	2,437
Deferred tax liability	95	86
Total liabilities	145,803	143,611
Commitments and contingencies (Note 15)		
Stockholders' equity:		
Preferred stock, no par value; 1,000 shares authorized; no shares issued or outstanding		
Common stock and additional paid-in capital, no par value; 29,000 shares authorized; 13,308 and 12,193 shares issued and outstanding	39,177	35,047
Accumulated deficit	(20,981)	(18,713)
Total stockholders' equity	18,196	16,334
Noncontrolling interest in subsidiaries	(326)	(841)
Total equity	17,870	15,493
Total liabilities and equity	\$ 163,673	\$ 159,104

See accompanying notes to consolidated financial statements

Table of Contents**ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES**

## CONSOLIDATED STATEMENTS OF OPERATIONS

*(Amounts in 000 s, except per share data)*

(Unaudited)

	<b>Three Months Ended March 31,</b>	
	<b>2012</b>	
	<b>Restated</b>	
	<b>(Note 2)</b>	<b>2011</b>
<b>Revenues:</b>		
Patient care revenues	\$ 46,307	\$ 30,532
Management revenues	524	498
Total revenues	46,831	31,030
<b>Expenses:</b>		
Cost of services (exclusive of facility rent, depreciation and amortization)	38,807	25,175
General and administrative	3,993	2,924
Facility rent expense	2,065	1,903
Depreciation and amortization	1,710	647
Total expenses	46,575	30,649
Income from Operations	256	381
<b>Other Income (Expense):</b>		
Interest expense, net	(2,678)	(1,436)
Acquisition costs, net of gains	(293)	979
Derivative gain (loss)	410	(1,350)
Other (expense) income	(14)	606
Total other expense, net	(2,575)	(1,201)
Loss from Continuing Operations Before Income Taxes	(2,319)	(820)
Income tax benefit (expense)	15	(86)
Loss from Continuing Operations	(2,304)	(906)
Loss from Discontinued Operations, Net of Tax	(109)	(35)
Net Loss	(2,413)	(941)
Net Loss Attributable to Noncontrolling Interests	145	176
Net Loss Attributable to AdCare Health Systems, Inc.	\$ (2,268)	\$ (765)
<b>Net Loss per Common Share Basic:</b>		
Continuing Operations	\$ (0.18)	\$ (0.08)
Discontinued Operations	(0.01)	(0.01)
	\$ (0.19)	\$ (0.09)
<b>Net Loss per Common Share Diluted:</b>		
Continuing Operations	\$ (0.18)	\$ (0.08)
Discontinued Operations	(0.01)	(0.01)
	\$ (0.19)	\$ (0.09)
<b>Weighted Average Common Shares Outstanding:</b>		
Basic	12,225	8,767
Diluted	12,225	8,767



See accompanying notes to consolidated financial statements

Table of Contents**ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY***(Amounts in 000 \$)**(Unaudited)*

	<b>Common Stock Shares</b>	<b>Common Stock and Additional Paid-in Capital Restated (Note 2)</b>	<b>Accumulated Deficit Restated (Note 2)</b>	<b>Noncontrolling Interests Restated (Note 2)</b>	<b>Total Restated (Note 2)</b>
Balance, January 1, 2012	12,193	\$ 35,047	\$ (18,713)	\$ (841)	\$ 15,493
Deconsolidation of variable interest entities				660	660
Nonemployee warrants for services		276			276
Stock-based compensation expense		190			190
Public stock offering, net	1,100	3,641			3,641
Exercises of options and warrants	15	23			23
Net loss			(2,268)	(145)	(2,413)
Balance, March 31, 2012	13,308	\$ 39,177	\$ (20,981)	\$ (326)	\$ 17,870

See accompanying notes to consolidated financial statements

Table of Contents**ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES**

## CONSOLIDATED STATEMENTS OF CASH FLOWS

*(Amounts in 000 \$)*

(Unaudited)

	<b>Three Months Ended March 31,</b>	
	<b>2012</b>	
	<b>Restated</b>	
	<b>(Note 2)</b>	<b>2011</b>
<b>Cash flows from operating activities:</b>		
Net Loss	\$ (2,413)	\$ (941)
Loss from discontinued operations, net of tax	109	35
Loss from continuing operations	(2,304)	(906)
Adjustments to reconcile net loss from continuing operations to net cash provided by operating activities:		
Depreciation and amortization	1,710	647
Warrants issued for services		32
Stock-based compensation expense	190	358
Lease expense in excess of cash	157	193
Amortization of deferred financing costs	337	132
Amortization of debt discounts	213	216
Derivative (gain) loss	(410)	1,350
Deferred tax expense	9	45
(Gain) loss on disposal of assets	(2)	21
Gain on acquisitions		(1,104)
Provision for bad debts	918	102
Other noncash items		24
Changes in certain assets and liabilities, net of acquisitions:		
Accounts receivable	(3,051)	(2,587)
Prepaid expenses and other	(200)	(487)
Other assets	180	(128)
Accounts payable and accrued expenses	3,860	2,715
Net cash provided by operating activities continuing operations	1,607	623
Net cash (used in) provided by operating activities discontinued operations	(105)	160
Net cash provided by operating activities	1,502	783
<b>Cash flows from investing activities:</b>		
Proceeds from sale of property and equipment	3	
Change in restricted cash and investments and escrow deposits for acquisitions	566	573
Acquisitions	(7,919)	(5,595)
Purchase of property and equipment	(463)	(468)
Net cash used in investing activities continuing operations	(7,813)	(5,490)
Net cash used in investing activities discontinued operations		
Net cash used in investing activities	(7,813)	(5,490)
<b>Cash flows from financing activities:</b>		
Proceeds from debt	8,488	8,138
Debt issuance costs	(206)	(123)
Change in lines of credit	(556)	3,013
Exercise of warrants and options	23	
Proceeds from stock issuances, net	3,641	
Repayment of notes payable	(1,215)	(482)

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Net cash provided by financing activities – continuing operations	10,175	10,546
Net cash used in financing activities – discontinued operations	(48)	(46)
Net cash provided by financing activities	10,127	10,500
Net Change in Cash	3,816	5,793
Cash, Beginning	7,364	3,911
Cash decrease due to deconsolidation of variable interest entities (Note 2)	(180)	
Cash, Ending	\$ 11,000	\$ 9,704

Supplemental Disclosure of Cash Flow Information:

Cash paid during the period for:

Interest	\$ 2,554	\$ 1,017
Income taxes	\$	\$

Supplemental Disclosure of Non-cash Activities:

Acquisitions in exchange for debt and equity instruments	\$ 5,000	\$
Warrants issued for financings costs	\$ 276	\$ 330
Non-cash debt issuance costs	\$	\$ 361

See accompanying notes to consolidated financial statements

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**ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

(Unaudited)

**NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

***Basis of Presentation***

The consolidated financial statements are presented in accordance with accounting principles generally accepted in the United States. These statements include the accounts of AdCare Health Systems, Inc. and its controlled subsidiaries (collectively, AdCare, the Company or we). Controlled subsidiaries include AdCare's majority owned subsidiaries and variable interest entities in which AdCare has control as primary beneficiary. The Company delivers skilled nursing, assisted living and home health services through wholly owned separate operating subsidiaries. All inter-company accounts and transactions were eliminated in the consolidation. The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 8-03 of Regulation S-X. Accordingly, they do not include all of the information and notes required for complete annual financial statements and should be read in conjunction with the Company's audited consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 (the Annual Report). In the opinion of the Company's management, all adjustments considered for a fair presentation are included and are of a normal recurring nature. Operating results for the three months ended March 31, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. Certain prior year amounts have been reclassified to conform to the current year presentation.

As described in the Explanatory Note to this Form 10-Q/A and in Note 2, the interim consolidated financial statements for 2012 presented herein have been restated from those previously issued.

***Earnings per Share***

Basic earnings per share is computed by dividing net income or loss by the weighted-average number of common shares outstanding during the period. Diluted earnings per share is similar to basic earnings per share except net income or loss is adjusted by the impact of the assumed issuance of common shares upon conversion of convertible securities and the weighted-average number of common shares outstanding includes potentially dilutive securities, such as options, warrants, non-vested shares, and additional shares issuable under convertible notes outstanding during the period when such potentially dilutive securities are not anti-dilutive. Potentially dilutive securities from options, warrants and non-vested shares are calculated in accordance with the treasury stock method, which assumes that proceeds from the exercise of all options and warrants with exercise prices exceeding the average market value are used to repurchase common stock at market value. The incremental shares remaining after the proceeds are exhausted represent the potentially dilutive effect of the securities. Potentially dilutive securities from convertible debt are calculated based on the assumed issuance at the beginning of the period, as well as any adjustment to income that would result from their assumed issuance.

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For the three months ended March 31, 2012 and 2011, due to the net loss for both periods, no potentially dilutive securities were included in the diluted earnings per share calculation because to do so would be anti-dilutive.

*Intangible Assets and Goodwill*

There have been no impairment adjustments to intangible assets and goodwill during the three months ended March 31, 2012 and 2011.

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Intangible assets consist of the following:

Amounts in (000 s)	Lease Rights	Bed Licenses (included in property and equipment) Restated (Note 2)	Bed Licenses - Separable	Total
Balances, December 31, 2011, net	\$ 8,460	\$ 22,922	\$ 1,189	\$ 32,571
Deconsolidation of Oklahoma Owners		(3,458)		(3,458)
Acquisitions			1,188	1,188
Amortization expense	(267)	(134)		(401)
Balances, March 31, 2012, net	\$ 8,193	\$ 19,330	\$ 2,377	\$ 29,900

The following table summarizes the changes in the carrying amount of goodwill at March 31, 2012 as compared with December 31, 2011:

Amounts in (000 s)	March 31, 2012 Restated (Note 2)
Balance, December 31, 2011	\$ 3,600
Deconsolidation of Oklahoma Owners	(1,123)
Acquisitions	88
Impairment charge	
Balance, March 31, 2012	\$ 2,565

Goodwill as previously reported in the 2011 consolidated financial statements was \$0.9 million. In 2012, a reclassification adjustment was made to the December 31, 2011 balance sheet to recognize \$2.7 million of goodwill from 2011 acquisitions that was previously reported as bed licenses included in property and equipment. The Company does not amortize goodwill or indefinite lived intangibles.

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## Notes to Consolidated Financial Statements

(Unaudited)

**NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** *(continued)****Intangible Assets and Goodwill*** *(continued)*

Amortization expense was approximately \$134,000 for bed licenses included in property and equipment and \$267,000 for lease rights for the three months ended March 31, 2012. Estimated amortization expense for each of the following years ending December 31 is as follows:

(Amounts in 000 s)	<b>Bed Licenses Restated (Note 2)</b>		<b>Lease Rights</b>	
2012 (remainder)	\$	401	\$	802
2013		534		1,069
2014		534		1,010
2015		534		885
2016		534		885
Thereafter		16,793		3,542
<b>Total</b>	<b>\$</b>	<b>19,330</b>	<b>\$</b>	<b>8,193</b>

**NOTE 2. RESTATEMENT OF PREVIOUSLY ISSUED CONSOLIDATED FINANCIAL STATEMENTS**

In this Amendment No.1 on Form 10-Q/A to the Company's Quarterly Report on Form 10-Q for the three months ended March 31, 2012, we are restating the consolidated financial statements for the first quarter of 2012. Concurrent with the filing of this Form 10-Q/A, we are also filing amended quarterly reports on Form 10-Q/A for each of the second and third quarters of 2012 to restate our consolidated financial statements therein. The effects of these restatements, to the extent applicable, are reflected in the items revised herein. The restatements relate to the following:

- Correction in the application of the Company's accounting for certain variable interest entities further described as follows:

As further discussed in Note 19, *Variable Interest Entities*, and Note 21, *Related Party Transactions*, found in the Company's audited consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 (the Annual Report), effective August 1, 2011 entities (the Oklahoma Owners) controlled by Christopher Brogdon and his spouse, Connie Brogdon (related parties to the Company) acquired five skilled nursing facilities located in Oklahoma (the Oklahoma Facilities). The Company entered



into a Management Agreement with the Oklahoma Owners pursuant to which a wholly-owned subsidiary of the Company supervises the management of the Oklahoma Facilities for a monthly fee equal to 5% of the monthly gross revenues of the Oklahoma Facilities. Upon acquisition, the Company concluded it was the primary beneficiary of the Oklahoma Owners and pursuant to Financial Accounting Standards Board Accounting Standards Codification Topic 810-10, *Consolidation-Overall*, consolidated the Oklahoma Owners in its 2011 consolidated financial statements.

During the process of finalizing the 2012 consolidated financial statements, the Company re-assessed its prior conclusion that it should consolidate the Oklahoma Owners. In the reassessment process, the Company concluded that it should not have consolidated the Oklahoma Owners. In the accompanying consolidated financial statements, the Company has deconsolidated the Oklahoma Owners effective January 1, 2012 and the balance sheet, operations and cash flows of the Oklahoma Owners are not included in the Company's first quarter 2012 consolidated financial statements. The Company further concluded that including the Oklahoma Owners in its 2011 consolidated financial statements was not material to such consolidated financial statements and therefore no adjustments have been made to the previously issued quarterly and annual 2011 consolidated financial statements.

- Accounting errors and certain accounting estimates that were identified in the process of finalizing our consolidated financial statements for the year ended December 31, 2012. These matters include the following:

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- *Patient care revenues and Accounts receivable, net* Adjustments totaling \$276,000 related primarily to the following items:

The timing of certain revenue recognition adjustments to ensure proper recognition in the appropriate interim reporting period within the 2012 year. Adjustments totaling \$276,000 related to the overstatement of \$140,000 in managed care revenue due to billing errors and a \$136,000 reclassification to reduce managed care revenue due to the improper recognition of bad debt expense subsequently identified by the Company.

- *Costs of services* Adjustments totaling \$1,617,000 related primarily to the following items:

The timing of expense recognition related to direct care compensation obligations incurred for the facilities located in Arkansas to reflect proper recognition in the appropriate interim reporting period within the 2012 year totaling approximately \$918,000. The related expense and obligation was being recognized over the period until the respective payment date. However, the obligations should have been expensed immediately in the period incurred as the obligation related to prior services rendered.

The timing of recognition of certain payroll related operating expenses and other necessary adjustments to related accrued liabilities to ensure proper recognition in the appropriate interim reporting period within the 2012 year. The issues primarily relate to insufficient processes related to accounting for accrued vacation of \$162,000 and the untimely identification and recognition of expenses associated with certain unemployment tax accrual adjustments of \$42,000.

The timing of certain adjustments to the provision for bad debts in the appropriate interim reporting period within the 2012 year. The issues primarily related to required adjustments resulting from the timing of recognition for state recoupments for Medicaid overpayments for certain facilities totaling \$403,000 and the delays in collection efforts and lack of timely follow-up on open patient accounts in 2012 for certain facilities totaling \$67,000 offset by the improper recognition of bad debt expense relating to managed care revenue discussed above in the amount of \$136,000.

Additional adjustment of \$161,000 related to the reversal of the eliminated management fee expense associated with the correction in the application of the Company's accounting for certain variable interest entities which also has been recorded in costs of services.

- *General and administrative* - Adjustments totaling \$62,000 resulted primarily from \$25,000 of expense recognition related to an adjustment to the fair value of warrants granted to non-employees, \$22,000 of expense inadvertently capitalized on the balance sheet that should have been expensed in the interim reporting period in which the costs were incurred during the 2012 period, and \$15,000 due to the insufficient processes related to accounting for accrued vacation.

- *Depreciation and amortization* The impairment of an office building of \$389,000 acquired through a 2011 acquisition that was vacated and abandoned in first quarter of 2012 to market value less cost to sell was offset by \$68,000 resulting from a decrease in amortization of certain intangibles related to adjustments that decreased the underlying intangible asset values and increased the related goodwill

resulting from the respective acquisitions.

- *Property and equipment, net* Adjustments of \$343,000 related primarily to the \$389,000 impairment of an office building acquired in 2011 acquisition offset by \$68,000 resulting from a decrease in amortization of certain intangibles related to adjustments that decreased the underlying intangible asset values and increased the related goodwill resulting from the respective acquisitions and \$22,000 of expense inadvertently capitalized on the balance sheet that should have been expensed in the interim reporting period in which the costs were incurred during the 2012 period.
- *Goodwill and Intangible assets bed licenses* - Adjustment of \$88,000 related to an acquisition reclassification to goodwill from the capitalized intangible assets bed licenses during the 2012 period.

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- *Deferred loan costs, net* Adjustment of \$85,000 related to an adjustment to the fair value of warrants granted to non-employees which related to the costs incurred in connection with loan costs.
- *Statement of cash flows* Adjustments to the statement of cash flows result primarily from the adjustments related to the Oklahoma Owners as discussed above; changes in net loss and the related adjustments to the various working capital related balance sheet accounts resulting from the other adjustments described above; and adjustments to show \$4.7 million of debt incurred in conjunction with certain acquisitions as cash provided by financing activities and cash used in investing activities.

The following table presents the Company's previously issued (the "As Reported") and restated (the "As Restated") consolidated balance sheet as of March 31, 2012 (*in thousands*):

	March 31, 2012			
	As Reported	Oklahoma Owners	Other Adjustments	As Restated
<b>ASSETS</b>				
Cash and cash equivalents	\$ 11,328	\$ (328)	\$	\$ 11,000
Restricted cash and investments	1,208			1,208
Accounts receivable, net	21,396	(1,006)	(274)	20,116
Prepaid expenses and other	1,038	(211)		827
Assets of disposal group held for sale receivable, net	42			42
<b>Total current assets</b>	<b>35,012</b>	<b>(1,545)</b>	<b>(274)</b>	<b>33,193</b>
Restricted cash and investments	4,980			4,980
Property and equipment, net (net of reclassification of \$2,694 Note 1)	112,965	(9,919)	(343)	102,703
Intangible assets - bed licenses	2,464		(88)	2,377
Intangible assets - lease rights, net	8,193			8,193
Goodwill (reclassification of \$2,694 Note 1)	3,600	(1,123)	88	2,565
Escrow deposits for acquisitions	3,604			3,604
Lease deposits	1,686		(1)	1,685
Deferred loan costs, net	4,826	(610)	85	4,301
Other assets	74		(2)	72
<b>Total assets</b>	<b>\$ 177,404</b>	<b>\$ (13,197)</b>	<b>\$ (534)</b>	<b>\$ 163,673</b>
<b>LIABILITIES AND STOCKHOLDERS</b>				
<b>EQUITY</b>				
Current portion of notes payable and other debt	\$ 7,655	\$ (193)	\$	\$ 7,462
Revolving credit facilities and lines of credit	8,095			8,095
Accounts payable	14,655	(988)	331	13,998
Accrued expenses	10,952	(429)	1,042	11,565
Liabilities of disposal group held for sale	192			192
<b>Total current liabilities</b>	<b>41,549</b>	<b>(1,610)</b>	<b>1,373</b>	<b>41,312</b>
Senior debt, net of discounts	97,163	(12,339)		84,824
Convertible debt, net of discounts	14,824			14,824
Other debt	1,150			1,150
Derivative liability	1,479			1,479

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Other liabilities	2,119			2,119
Deferred tax liability	67		28	95
Total liabilities	158,351	(13,949)	1,401	145,803
Common stock and additional paid-in capital	39,068		109	39,177
Accumulated deficit	(18,919)		(2,062)	(20,981)
Total stockholders' equity	20,149		(1,953)	18,196
Noncontrolling interest in subsidiaries	(1,096)	752	18	(326)
Total equity	19,053	752	(1,935)	17,870
Total liabilities and equity	\$ 177,404	\$ (13,197)	\$ (534)	\$ 163,673

Table of Contents**NOTE 2. RESTATEMENT OF PREVIOUSLY ISSUED CONSOLIDATED FINANCIAL STATEMENTS** *(continued)*

The following table presents the Company's previously issued (the "As Reported") and restated (the "As Restated") consolidated statement of operations for the three months ended March 31, 2012 *(in thousands, except per share information)*:

	<b>Three Months Ended March 31, 2012</b>			
	<b>As Reported</b>	<b>Oklahoma Owners</b>	<b>Other Adjustments</b>	<b>As Restated</b>
<b>Revenues</b>				
Patient care revenues	\$ 49,808	\$ (3,225)	\$ (276)	\$ 46,307
Management revenues	363		161	524
Total revenues	50,171	(3,225)	(115)	46,831
<b>Expenses:</b>				
Cost of services (Exclusive of facility rent, depreciation and amortization)	40,123	(2,933)	1,617	38,807
General and administrative	3,931		62	3,993
Facility rent expense	2,065			2,065
Depreciation and amortization	1,497	(108)	321	1,710
Total expenses	47,616	(3,041)	2,000	46,575
Income from Operations	2,555	(184)	(2,115)	256
<b>Other Income (Expense):</b>				
Interest expense, net	(2,954)	276		(2,678)
Acquisition costs, net of gains	(293)			(293)
Derivative gain	410			410
Other expense	(16)		2	(14)
Total other expense, net	(2,853)	276	2	(2,575)
<b>Loss from Continuing Operations Before</b>				
Income Taxes	(298)	92	(2,113)	(2,319)
Income tax benefit (expense)	(54)		69	15
Loss from Continuing Operations	(352)	92	(2,044)	(2,304)
Loss from discontinued operations, net of tax	(109)			(109)
Net Loss	(461)	92	(2,044)	(2,413)
Net Loss Attributable to Noncontrolling Interest	255	(92)	(18)	145
Net Loss Attributable to AdCare Health Systems, Inc.	\$ (206)	\$	\$ (2,062)	\$ (2,268)
<b>Net Loss per Common Share - Basic:</b>				
Continuing Operations	\$ (0.01)		\$ (0.17)	\$ (0.18)
Discontinued Operations	\$ (0.01)			\$ (0.01)
	\$ (0.02)		\$ (0.17)	\$ (0.19)
<b>Net Loss per Common Share - Diluted</b>				
Continuing Operations	\$ (0.01)		\$ (0.17)	\$ (0.18)
Discontinued Operations	\$ (0.01)			\$ (0.01)
	\$ (0.02)		\$ (0.17)	\$ (0.19)

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Weighted Average Common Shares

Outstanding:

Basic	12,204	21	12,225
Diluted	12,204	21	12,225

Table of Contents**NOTE 2. RESTATEMENT OF PREVIOUSLY ISSUED CONSOLIDATED FINANCIAL STATEMENTS** *(continued)*

The following table presents the Company's previously issued (the "As Reported") and restated (the "As Restated") statement of cash flows for the three months ended March 31, 2012 *(in thousands)*:

	As Reported	Three Months Ended March 31, 2012		As Restated
		Oklahoma Owners	Other Adjustments	
<b>Cash flows from operating activities:</b>				
Net loss	\$ (461)	\$ 92	\$ (2,044)	\$ (2,413)
Loss from discontinued operations, net of tax	109			109
Loss from continuing operations	(352)	92	(2,044)	(2,304)
Adjustments to reconcile net loss from continuing operations to net cash provided by operating activities:				
Depreciation and amortization	1,497	(108)	321	1,710
Warrants issued for services				
Stock based compensation expense	165		25	190
Lease expense in excess of cash	157			157
Amortization of deferred financing costs	381	(52)	8	337
Amortization of debt discounts	213			213
Derivative gain	(410)			(410)
Deferred tax (benefit) expense	(19)		28	9
Gain on disposal of assets	(2)			(2)
Provision for bad debts	615	(26)	329	918
Other noncash items	16		(16)	
Changes in certain assets and liabilities, net of acquisitions:				
Accounts receivable	(3,151)	231	(131)	(3,051)
Prepaid expenses and other	(373)	175	(2)	(200)
Other assets	(22)	57	145	180
Accounts payable and accrued expenses	3,351	(601)	1,110	3,860
Net cash provided by operating activities continuing operations	2,066	(232)	(227)	1,607
Net cash used in operating activities discontinued operations	(204)		99	(105)
Net cash provided by operating activities	1,862	(232)	(128)	1,502
<b>Cash flows from investing activities:</b>				
Proceeds from sale of property and equipment	3			3
Change in restricted cash and investments and escrow deposits for acquisitions	637		(71)	566
Acquisitions	(3,130)		(4,789)	(7,919)
Purchase of property and equipment	(522)	38	21	(463)
Net cash used in investing activities continuing operations	(3,012)	38	(4,839)	(7,813)
Net cash used in investing activities discontinued operations				
Net cash used in investing activities	(3,012)	38	(4,839)	(7,813)
<b>Cash flows from financing activities:</b>				
Proceeds from debt	3,523		272	3,795
Proceeds from debt used in acquisitions			4,693	4,693



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Debt issuance costs				(206)		(206)
Change in line of credit		(556)				(556)
Exercise of warrants and options		23				23
Proceeds from stock issuances, net		3,642		(1)		3,641
Repayment of notes payable		(1,470)	46	209		(1,215)
Net cash provided by financing activities continuing operations		5,162	46	4,967		10,175
Net cash used in financing activities discontinued operations		(48)				(48)
Net cash provided by financing activities		5,114	46	4,967		10,127
Net Change in cash		3,964	(148)			3,816
Cash, Beginning		7,364	(180)			7,184
Cash, Ending	\$	11,328	\$	(328)	\$	\$ 11,000
Supplemental Disclosure of Cash Flow Information:						
Cash paid during the period for:						
Interest	\$	2,238	\$	\$	316	\$ 2,554
Income taxes	\$	13	\$	\$	(13)	\$
Supplemental Disclosure of Non-cash Activities:						
Acquisitions in exchange for debt and equity instruments	\$	9,800	\$	\$	(4,800)	\$ 5,000
Warrants issued for financings costs	\$	191	\$	\$	85	\$ 276
Noncash debt issuance costs	\$	164	\$	\$	(164)	\$

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**NOTE 3. LIQUIDITY AND PROFITABILITY**

The Company had a net loss of approximately \$2,413,000 for the three months ended March 31, 2012, and had negative working capital of approximately \$8,119,000 at March 31, 2012. The Company's ability to achieve sustained profitable operations is dependent on continued growth in revenue and controlling costs.

Management's plans for increasing liquidity and profitability in future years encompass the following:

- refinancing debt where possible to obtain more favorable terms;
- increasing facility occupancy and improving the occupancy mix by increasing Medicare patients;
- acquiring additional long term care facilities with existing cash flowing operations to expand our operations; and
- adding additional management contracts.

Management believes that the foregoing actions, if taken by the Company, should provide the opportunity for the Company to improve liquidity and achieve profitability; however, there is no assurance that such actions will occur. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

**NOTE 4. DISCONTINUED OPERATIONS**

As part of the Company's strategy to focus on the growth of its skilled nursing segment, the Company decided in the fourth quarter of 2011 to exit the home health segment of the business. This segment represented less than 2% of total revenues for the Company over the past year.

As a result of the decision to exit the home health business, the assets and liabilities that are expected to be sold are reflected as assets and liabilities held for sale and are comprised of the following:

(Amounts in 000's)	March 31, 2012		December 31, 2011	
Property and equipment, net	\$	40	\$	45
Other assets		2		2
Assets of disposal group held for sale	\$	42	\$	47
Current portion of debt	\$	192	\$	197
Notes payable				43

Liabilities of disposal group held for sale	\$	192	\$	240
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Table of Contents**ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES**

## Notes to Consolidated Financial Statements

(Unaudited)

**NOTE 5. SEGMENTS**

The Company reports its operations in three segments: Skilled Nursing Facility ( SNF ), Assisted Living Facility ( ALF ), and Corporate & Other. The SNF and ALF segments provide services to individuals needing long-term care in a nursing home or assisted living setting and management of those facilities. The Corporate & Other segment engages in the management of facilities and accounting and IT services. We evaluate financial performance and allocate resources primarily based upon segment operating income (loss). Segment operating results exclude interest expense and other non-operating income and expenses. The table below contains our segment information for the three months ended March 31, 2012 and 2011.

(Amounts in 000 s)	SNF	ALF	Corporate & Other	Eliminations	Total
<b>Three months ended</b>					
<b>March 31, 2012 Restated</b>					
<b>(Note 2)</b>					
Net revenue	\$ 43,044	\$ 3,263	\$ 2,849	\$ (2,325)	\$ 46,831
Cost of services	38,763	2,369		(2,325)	38,807
General and administrative	36		3,957		3,993
Facility rent expense	2,065				2,065
Depreciation and amortization	1,330	210	170		1,710
Operating income/(loss)	\$ 850	\$ 684	\$ (1,278)	\$	\$ 256
Total assets, March 31, 2012	\$ 105,663	\$ 27,389	\$ 40,470	\$ (9,849)	\$ 163,673
<b>Three months ended</b>					
<b>March 31, 2011</b>					
Net revenue	\$ 28,191	\$ 2,341	\$ 2,712	\$ (2,214)	\$ 31,030
Cost of services	25,324	1,985	80	(2,214)	25,175
General and administrative			2,924		2,924
Facility rent expense	1,903				1,903
Depreciation and amortization	459	152	36		647
Operating income/(loss)	\$ 505	\$ 204	\$ (328)	\$	\$ 381
Total assets, December 31, 2011	\$ 110,532	\$ 22,328	\$ 35,792	\$ (9,548)	\$ 159,104

**NOTE 6. PROPERTY AND EQUIPMENT**

(Amounts in 000 s)	Estimated Useful Lives (Years)	March 31, 2012 Restated (Note 2)	December 31, 2011
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Buildings and improvements	5-40	\$	94,514	\$	93,371
Equipment	2-10		7,501		7,108
Land			7,346		7,636
Computer related	2-10		2,433		2,414
Construction in process			245		77
			112,039		110,606
Less: accumulated depreciation expense			8,761		7,624
Less: accumulated amortization expense			575		533
Property and equipment, net		\$	102,703	\$	102,449

For the quarters ended March 31, 2012 and 2011, depreciation and amortization expense was approximately \$1,710,000 and \$647,000, respectively.

In 2012, a reclassification adjustment was made to the December 31, 2011 balance sheet to recognize \$2.7 million of goodwill acquired in acquisitions that was previously reported as bed licenses included in property and equipment. The Company does not amortize goodwill or indefinite lived intangibles.

During the quarter ended March 31, 2012, the Company recognized a \$389,000 impairment charge to write down the carrying value of an office building located in Rogers, Arkansas. The office building was acquired in a 2011 acquisition. The purchase price allocation for that acquisition was deemed to be final as of December 31, 2011. Subsequent to December 31, 2011, it was determined that the acquired office building would not be utilized and the building was not in use as of March 31, 2012. The impairment charge represents a change in fair value from value recognized in the purchase price allocation. The impairment charge is classified as depreciation expense in the consolidated statement of operations and is included in the Company's Skilled Nursing Facility segment.

Table of Contents**NOTE 7. RESTRICTED CASH AND INVESTMENTS**

The following table sets forth the Company's various restricted cash, escrow deposits and investments:

(Amounts in 000 \$)	March 31, 2012	December 31, 2011
HUD escrow deposits	\$ 172	\$ 326
Funds held in trust for residents	24	45
Refundable escrow deposit		500
Collateral certificates of deposit	1,012	1,012
Total current portion	1,208	1,883
HUD reserve replacement	1,143	1,130
Reserves for capital improvements	1,836	1,767
Restricted investments for other debt obligations	2,001	1,973
Total noncurrent portion	4,980	4,870
Total restricted cash and investments	\$ 6,188	\$ 6,753

*Refundable escrow deposit* In March 2012, the Company terminated an agreement to acquire or lease 15 skilled nursing facilities and, as a result of such termination, the deposit was refunded.

**NOTE 8. ACCRUED EXPENSES**

Accrued expenses consist of the following:

(Amounts in 000 \$)	March 31, 2012 Restated (Note 2)	December 31, 2011
Accrued payroll related	\$ 5,146	\$ 5,040
Accrued employee benefits	3,224	2,023
Real estate and other taxes	1,166	982
Other accrued expenses	2,029	1,836
Total accrued expenses	\$ 11,565	\$ 9,881

**NOTE 9. NOTES PAYABLE AND OTHER DEBT**

Notes payable and other debt consists of the following:

(Amounts in 000 s)	March 31, 2012 Restated (Note 2)	December 31, 2011
Revolving credit facilities and lines of credit	\$ 8,095	\$ 8,651
Senior debt - guaranteed by HUD	15,869	15,738
Senior debt - guaranteed by USDA	28,796	38,717
Senior debt - guaranteed by SBA	5,040	5,087
Senior debt - bonds, net of discount	6,179	6,176
Senior debt - other mortgage indebtedness	31,043	23,823
Other debt	6,508	4,197
Convertible debt issued in 2010, net of discount	10,316	10,105
Convertible debt issued in 2011	4,509	4,509
Total notes payable and other debt	116,355	117,003
Less current portion	15,557	11,910
Notes payable and other debt, net of current portion	\$ 100,798	\$ 105,093

Table of Contents**NOTE 9. NOTES PAYABLE AND OTHER DEBT** *(continued)****Scheduled Maturities***

The following is a summary of the scheduled maturities of indebtedness as of March 31, 2012 for each of the next five years and thereafter:

	(Amounts in 000 s)	
2013	\$	15,557
2014		19,606
2015		1,898
2016		1,979
2017		2,140
Thereafter		76,695
Subtotal		117,875
Less: unamortized discounts		(1,520)
Total notes payable and other debt	\$	116,355

***Debt Covenant Compliance***

As of March 31, 2012, the Company (including its consolidated variable interest entity) had 26 different credit facilities (credit facilities, mortgage notes, bonds and other credit obligations) outstanding that include various financial and administrative covenant requirements. Covenant requirements include, but are not limited to, fixed charge coverage ratios, debt service coverage ratios, minimum EBITDA or EBITDAR, current ratios and tangible net worth requirements. Certain financial covenant requirements are based on consolidated financial measurements whereas others are based on subsidiary level (i.e., facility, multiple facilities or a combination of subsidiaries comprising less than the Company's consolidated financial measurements). Some covenants are based on annual financial metric measurements whereas others are based on monthly or quarterly financial metric measurements. The Company routinely tracks and monitors its compliance with its covenant requirements. In recent periods, including as of March 31, 2012, the Company has not been in compliance with certain financial and administrative covenants. For each instance of such non-compliance, the Company has obtained waivers or amendments to such requirements, including, as necessary, modifications to future covenant requirements or the elimination of certain requirements in future periods.

***Senior debt other mortgage indebtedness******Hearth and Home of Vandalia***

In January 2012, the Company refinanced the Hearth and Home of Vandalia facility through the issuance of a term loan insured by U.S. Department of Housing and Urban Development ( HUD ) with a financial institution for a total amount of \$3,721,500 that matures in 2041. The HUD term loan requires monthly principal and interest payments of approximately \$17,500 with a fixed interest rate of 3.74%. Deferred financing costs incurred on the term loan amounted to approximately \$201,000 and are being amortized to interest expense over the life of the



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HUD term loan. The HUD term loan has a prepayment penalty of 8% through 2014 declining by 1% each year through 2022.

### *Woodland Manor*

In connection with the January 2012 acquisition of the skilled nursing facility located in Springfield, Ohio, known as Woodland Manor, the Company entered into a loan agreement for \$4,800,000. The loan matures in December 2016 with a required final payment of approximately \$4,300,000 and accrues interest at the LIBOR rate plus 4% with a minimum rate of 6% per annum. The loan requires monthly principal payments of \$8,500 plus interest for total current monthly payments of approximately \$33,000. Deferred financing costs incurred on the loan amounted to approximately \$107,300 and are being amortized to interest expense over the life of the loan. The loan has a prepayment penalty of 5% through 2012 declining by 1% each year through 2015. The loan is secured by the Woodland Manor facility and guaranteed by AdCare.

### *Eaglewood Village*

In connection with the January 2012 acquisition of the assisted living facility located in Springfield, Ohio, known as Eaglewood Village, the Company entered into a loan agreement for \$4,500,000. The loan matures in June 2012 and accrues interest at 6.5% per annum from January 1, 2012 through February 29, 2012, 8.5% per annum from March 1, 2012 through April 30, 2012 and 10.5% per annum after May 1, 2012. The loan may be prepaid at any time without penalty. The loan is secured by the Eaglewood Village facility and guaranteed by AdCare. The loan is due within one year but has been classified as long-term because the Company refinanced this short-term obligation on April 12, 2012 (see Note 15).

### ***Other Debt***

#### *Eaglewood Village Promissory Note*

In connection with the January 2012 acquisition of Eaglewood Village, Eaglewood Village, LLC and Eaglewood Property Holdings, LLC, each a wholly owned subsidiary of AdCare, issued a promissory note in the amount of \$500,000. The note matures in January 2014 and bears interest at 6.5% per annum payable monthly beginning February 2012. The note requires monthly principal and interest payments of \$3,700. The note may be prepaid without penalty at any time.

Table of Contents**NOTE 9. NOTES PAYABLE AND OTHER DEBT** *(continued)***Other Debt** *(continued)**Cantone Promissory Note*

In March 2012, the Company issued a promissory note to Cantone Asset Management LLC in the amount of \$3,500,000. The promissory note bears interest at 10% per annum and matures in October 2012. The interest rate increases 1% each month beginning in July 2012 through October 2012. The note may also be prepaid without penalty at any time. In connection with the issuance of the note, Cantone Research, Inc. has agreed to provide us with certain consulting services for a monthly fee if the Company and Cantone Asset Management LLC (or an affiliated entity) do not agree to the terms of an additional financing arrangement pursuant to which it (or affiliated entity) would loan to us at least \$4,000,000 for a four-year term.

**NOTE 10. ACQUISITIONS***Summary of 2012 Acquisitions*

During the quarter ended March 31, 2012, the Company acquired one skilled nursing facility and one assisted living facility described further below and is pursuing a number of other acquisitions. The Company has incurred a total of approximately \$293,000 of acquisition costs in the Other Income (Expense) section of the Consolidated Statements of Operations.

*Woodland Manor and Eaglewood Village*

On January 1, 2012, the Company acquired one skilled nursing facility and one assisted living facility both located in Springfield, Ohio. The total purchase price was \$12,412,000 after final closing adjustments.

	(Amounts in 000 s)	
<b>Consideration Transferred:</b>		
Net proceeds from loans	\$	4,693
Seller notes		5,000
Cash from earnest money deposits		250
Cash (prepaid on December 30, 2011)		2,469
Total consideration transferred	\$	12,412

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Assets Acquired:		
Land	\$	370
Building		9,656
Equipment and Furnishings		1,199
Intangible Assets - bed licenses		1,188
Goodwill		87
Total assets acquired		12,500
Liabilities Assumed:		
Real estate taxes and other		(88)
Total identifiable net assets	\$	12,412

*Unaudited Pro forma Financial Information*

Acquisitions have been included in the consolidated financial statements since the dates the Company gained control. Combined revenue for all 2012 acquisitions is approximately \$2,474,000 and resulted in income from operations of approximately \$401,000.

The following table represents pro forma results of consolidated operations as if all of the 2011 and 2012 acquisitions had occurred at the beginning of the earliest fiscal year being presented, after giving effect to certain adjustments.

(Amounts in 000 \$)	Three Months Ended March 31,			
		2012		2011
Pro Forma Revenue	\$	46,831	\$	45,843
Pro Forma Operating Expenses	\$	46,570	\$	44,336
Pro Forma Income from Operations	\$	260	\$	1,507

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**NOTE 10. ACQUISITIONS** *(continued)*

*Unaudited Pro forma Financial Information (continued)*

The forgoing pro forma information is not indicative of what the results of operations would have been if the acquisitions had actually occurred at the beginning of the periods presented and is not intended as a projection of future results or trends.

**NOTE 11. STOCKHOLDERS EQUITY**

*2012 Public Stock Offering*

In March 2012, the Company closed a firm commitment underwritten public offering of 1,100,000 shares of common stock at an offering price to the public of \$3.75 per share. The Company received net proceeds of approximately \$3.6 million after deducting underwriting discounts, and other offering-related expenses of approximately \$0.5 million. The Company has also granted the underwriter in the offering an option for 45 days to purchase up to an additional 165,000 shares of common stock to cover over-allotments, if any. This overallotment option expired on May 11, 2012.

**NOTE 12. STOCK BASED COMPENSATION**

*Employee Common Stock Warrants & Options*

In February 2012, the Company granted non-qualified stock options to Christopher Brogdon, the Company's Vice Chairman and Chief Acquisition Officer, pursuant to the Company's 2011 Stock Incentive Plan (the 2011 Plan). A total of 50,000 options were granted with an exercise price per share of \$7.00 and 100,000 options were granted with an exercise price of \$8.00. The options vest in September of 2013 and 2014, respectively. The options are exercisable until the term expires in February, 2022. The fair value of the options was estimated at \$1.19 and \$1.03 per share, respectively, and is being recognized as share-based compensation expense over the requisite service period of the awards.

In March 2012, the Company granted incentive stock options to certain members of management pursuant to the 2011 Plan. A total of 429,200 options were granted with an exercise price per share of \$4.13. The options vest ratably on the day before each of the three subsequent anniversaries. The options are exercisable until the term expires in March, 2017. The fair value of the options was estimated at \$1.34 per share and is being recognized as share-based compensation expense over the requisite service period of the awards.

*Nonemployee Common Stock Warrants*

On March 29, 2012, in connection with the issuance of the \$3,500,000 promissory note to Cantone Asset Management LLC, the Company granted to Cantone Asset Management LLC a warrant to purchase 300,000 shares of common stock at an exercise price per share of \$4.00. The warrant is exercisable until the term expires in March, 2015. The fair value of the warrant was estimated at \$0.64 per share and is included in deferred loan costs and will be amortized as interest expense over the life of the promissory note. During the restatement process (Note 2), the fair value of the warrants was reviewed, and the Company determined that the warrants should be revalued using an estimated life correlating to the legal term of the warrant. The revised fair value was estimated to be \$0.92; the additional expense is included in deferred loan costs and is being amortized as interest expense over the life of the promissory note.

**NOTE 13. VARIABLE INTEREST ENTITIES**

As further described in Note 19 to the consolidated financial statements in the Annual Report, the Company has certain variable interest entities that are required to be consolidated. In connection with the restatement process (Note 2), the Company has determined that certain entities which the Company had previously recognized as variable interest entities and consolidated their results with the results of the Company during the first three quarters of 2012 as well as the third and fourth quarter of 2011, should not have been consolidated. These entities are the five skilled nursing facilities located in Oklahoma which are managed by the Company (known as the Oklahoma Owners). As a result of the restatements described in Note 2, the Company's consolidated financial statements for the first quarter of 2012 do not include the results of the Oklahoma Owners. The Company concluded that including the Oklahoma Owners in its 2011 consolidated financial statements was not material to such consolidated financial statements and therefore no adjustments have been made to the previously issued quarterly and annual 2011 consolidated financial statements. The following summarizes the assets and liabilities of the variable interest entities included in the consolidated balance sheets at March 31, 2012 and December 31, 2011:

Table of Contents**NOTE 13. VARIABLE INTEREST ENTITIES** *(continued)*

Riverchase Village Facility - Assets and Liabilities:

(Amounts in 000 s)	March 31, 2012	December 31, 2011
Cash	\$ 4	\$ 16
Accounts receivable	21	10
Restricted investments	470	451
Property and equipment, net	5,959	5,999
Other assets	452	432
Total assets	\$ 6,906	\$ 6,908
Accounts payable	\$ 826	\$ 740
Accrued expenses	227	173
Notes payable	6,179	6,176
Noncontrolling interest	(326)	(181)
Total liabilities	\$ 6,906	\$ 6,908

The balances related to the Oklahoma Owners variable interest entities that were consolidated as of December 31, 2011 but that the Company subsequently determined should not be consolidated were as follows:

(Amounts in 000 s)	December 31, 2011
Cash	\$ 180
Accounts receivable	800
Property and equipment, net	9,988
Goodwill	1,123
Other assets	641
Total assets	\$ 12,732
Accounts Payable	\$ 458
Accrued expenses	356
Notes payable	12,578
Noncontrolling interest	(660)
Total liabilities	\$ 12,732

**NOTE 14. FAIR VALUE MEASUREMENTS**

The following are the major categories of assets and liabilities measured at fair value on a recurring basis during the three months ended March 31, 2012, using quoted prices in active markets for identical assets (Level 1); significant other observable inputs (Level 2); and significant unobservable inputs (Level 3).

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(Amounts in 000 s)	Level 1:	Level 2:	Level 3:	Total at March 31, 2012	
Derivative Liability	\$	\$	\$ 1,479	\$	1,479

Following is a reconciliation of the beginning and ending balances for the derivative liability measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the period ended March 31, 2012:

(Amounts in 000 s)	Derivative Liability	
Beginning Balance	\$	1,889
Additions		
Total gain		(410)
Ending Balance	\$	1,479

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**NOTE 15. COMMITMENTS AND CONTINGENCIES**

*Legal Matters*

The skilled nursing business involves a significant risk of liability given the age and health of the Company's patients and residents and the services the Company provides. The Company and others in the industry are subject to an increasing number of claims and lawsuits, including professional liability claims, which may allege that services have resulted in personal injury, elder abuse, wrongful death or other related claims. The defense of these lawsuits may result in significant legal costs, regardless of the outcome, and can result in large settlement amounts or damage awards.

In addition to the potential lawsuits and claims described above, the Company is also subject to potential lawsuits under the Federal False Claims Act and comparable state laws alleging submission of fraudulent claims for services to any healthcare program (such as Medicare) or payor. A violation may provide the basis for exclusion from federally-funded healthcare programs. As of March 31, 2012, the Company does not have any material loss contingencies recorded or requiring disclosure based on management's evaluation of the probability of loss from known claims.

*Commitments*

Arkansas - Little Rock, Northridge and Woodland Hills

On December 29, 2011, the Company entered into a Purchase and Sale Agreement to purchase three skilled nursing facilities located in Little Rock, Arkansas for a total purchase price of \$27,280,000. Subsequent to December 31, 2011, the Company was required to deposit \$1,100,000 into escrow to be held as earnest money. If the agreement is terminated due to the sellers' failure to satisfy certain conditions set forth therein, then the deposit shall be returned to the Company. If the Company does not consummate the purchase, the sellers will retain the deposit. The Company extended the closing to March 31, 2012, with the payment of an additional \$500,000 in earnest money, and also deposited \$1,200,000 into escrow to be held as an earnest deposit.

Arkansas - Abington

On January 3, 2012, the Company entered into a Purchase and Sale Agreement with SCLR, LLC to acquire certain land, buildings, improvements, furniture, fixtures, operating agreements and equipment comprising Abington Place Health and Rehab Center, a 120-bed skilled nursing facility located in Little Rock, Arkansas, for an aggregate purchase price of \$3,600,000. Pursuant to the agreement, the Company deposited \$150,000 into escrow to be held as earnest money. Upon consummation of the purchase, the deposit will be retained by the Abington Place Seller and applied against the purchase price. The closing of the Abington Place purchase is expected to occur on April 1, 2012. The Company may extend the closing until April 30, 2012, subject to payment of an additional \$100,000 in earnest money.



Westlake / Quail Creek

On March 12, 2012, we entered into a Purchase and Sale Agreement with Westlake Nursing Home Limited to acquire a 118-bed skilled nursing facility located in Oklahoma City, Oklahoma, for an aggregate purchase price of \$5,800,000. Pursuant to the Purchase and Sale Agreement, we deposited \$25,000 into escrow to be held as earnest money. We expect the closing of the acquisition to occur on May 15, 2012.

Tulsa Companion Care

On March 14, 2012, we entered into a Purchase and Sale Agreement with F & F Ventures, LLC and Tulsa Christian Care, Inc., doing business as Companions Specialized Care Center to acquire a 121-bed skilled nursing facility located in Tulsa, Oklahoma for an aggregate purchase price of \$5,750,000. The purchase price consists of a \$5,000,000 cash payment and the issuance of shares of our common stock with an aggregate value of \$750,000, with such shares valued at the average closing price of our common stock for the ten-day period ending on the last business day prior to the closing of the acquisition. Pursuant to the Purchase and Sale Agreement, we deposited \$150,000 into escrow to be held as earnest money. We expect the closing of the acquisition to occur on or before June 30, 2012. In addition, the Company and Tulsa Christian Care, Inc. entered into an interim management agreement for this skilled nursing facility effective April 1, 2012.

**NOTE 16. SUBSEQUENT EVENTS**

Strome Promissory Note

On April 1, 2012, the Company issued a promissory note to Strome Alpha Offshore Ltd., in the amount of \$5,000,000. The promissory note bears interest at 10% per annum and matures in November 2012. The note may also be prepaid without penalty at any time. In connection with the issuance of the promissory note, the Company granted to Strome Alpha Offshore Ltd. a warrant to purchase 312,500 shares of common stock at an exercise price per share of \$4.00. The warrant is exercisable until April, 2015. The fair value of the warrant was estimated at \$0.61 per share and will be included in financing costs and expensed over the life of the promissory note issued in connection with the financing. During the restatement process, the fair value of the warrants was reviewed, and the Company determined that the warrants should be revalued using a life equal to the term of the warrant. The revised fair value was estimated to be \$0.88; the additional expense is included in deferred loan costs and is being amortized as interest expense over the life of the promissory note.

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**NOTE 16. SUBSEQUENT EVENTS** *(continued)*

Arkansas Acquisition

On April 1, 2012, we completed the acquisition of: (i) Little Rock Health & Rehab, a 154-bed skilled nursing facility located in Little Rock, Arkansas; (ii) Northridge Healthcare and Rehabilitation, a 140-bed skilled nursing facility located in North Little Rock, Arkansas; and (iii) Woodland Hills Healthcare and Rehabilitation, a 140-bed skilled nursing facility located in Little Rock, Arkansas from Little Rock Aviv, L.L.C., Woodland Arkansas, L.L.C. and Northridge Arkansas, L.L.C., pursuant to the previously announced Purchase and Sale Agreement, between the sellers and AdCare Property Holdings, LLC, dated as of December 29, 2011, for an aggregate purchase price of \$27,280,000. In connection with the closing of this acquisition, Little Rock HC&R Property Holdings, LLC, Northridge HC&R Property Holdings, LLC, and Woodland Hills HC Property Holdings, LLC, each our wholly owned subsidiary, entered into a Loan Agreement with The PrivateBank and Trust Company in an aggregate principal amount of \$21,800,000.

The loan matures on March 30, 2017. Interest on the loan accrues on the principal balance thereof at an annual rate of the greater of (i) 6.0% per annum or (ii) the LIBOR rate plus 4.0% per annum, and payments for the interest and a portion of the principal balance are payable monthly, commencing on May 1, 2012. The entire outstanding principal balance of the loan, together with all accrued but unpaid interest thereon, is payable on March 30, 2017. The loan is secured by a first mortgage on the real property and improvements constituting the facilities and guaranteed by AdCare.

Glennville PSA

On April 3, 2012, the Company entered into an agreement to acquire a 160-bed skilled nursing facility located in Glennville, Georgia for an aggregate purchase price of \$8,240,000.

Springfield Bond Financing

On April 12, 2012, the Company entered into a bond loan agreement with the City of Springfield in the State of Ohio ( Springfield ), pursuant to which Springfield lent to the Company the proceeds from the sale of its Series 2012 Bonds, which consists of the (i) \$6,610,000 The City of Springfield, Ohio, First Mortgage Revenue Bonds (Eaglewood Property Holdings, LLC Project), Series 2012A (the Series 2012A Bonds ); and (ii) \$620,000 The City of Springfield, Ohio, First Mortgage Revenue Bonds (Eaglewood Property Holdings, LLC Project), Taxable Series 2012B (the Series 2012B Bonds ; collectively, the Series 2012 Bonds ). The Series 2012A Bonds mature on May 1, 2042 and bear interest at 7.65% annually. The Series 2012B Bonds mature on May 1, 2021 and bear interest at 8.50% annually. The Company utilized the proceeds from the issuance of the Series 2012 Bonds to repay the \$4.5 million loan entered into to complete the acquisition of Eaglewood Village; make certain repairs and improvements to the Eaglewood Village facility; fund certain reserves; and pay the cost of the issuance of the Series 2012 Bonds.

Oklahoma PSA Amendment

On April 17, 2012, the Company amended its agreement with First Commercial Bank, to acquire six skilled nursing facilities located in Oklahoma. The amendment requires an additional deposit of \$50,000 into escrow to be used as earnest money; amends the closing date to the date which is sixty (60) days after all required licenses are received, but in no event later than September 30, 2012; and releases \$200,000 from escrow to First Commercial Bank. Upon the closing of the purchase, the Company shall receive a \$200,000 credit against the purchase price; however if the transaction fails to be consummated for any reason other than (i) default by First Commercial Bank; (ii) the failure of a condition to closing to be satisfied; or (iii) an event of casualty or condemnation, First Commercial Bank shall be entitled to retain the \$200,000 disbursed from escrow. If the transaction fails to be consummated for any reason other than as described in the preceding sentence, First Commercial Bank shall return the \$200,000 to the Company upon demand.

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**NOTE 16. SUBSEQUENT EVENTS** *(continued)*

Cantone Promissory Note April 2012

On April 27, 2012, we issued a promissory note in favor of Cantone Asset Management LLC for an aggregate principal amount of \$1,500,000. The note matures on the earlier of: (i) October 1, 2012; or (ii) the date on which we receive proceeds, in an amount not less than \$6,000,000, from a public offering or private placement of our common stock or debt securities. Interest on the note accrues on the principal balance thereof at an annual rate of 10%; provided, however, if the entire principal amount of the note is not paid by July 1, 2012, the interest rate shall increase by 1% for each month or part thereof during which any principal amount of the note shall remain unpaid. We may prepay the note in whole or in part, at any time, without notice or penalty; provided, however, if the note is prepaid prior to October 1, 2012, then we shall continue to pay interest on the note through such date. Payments of all amounts under the note are subordinate and junior in right of priority to the prior payment in full of a promissory note we issued to Cantone Asset Management LLC, dated March 30, 2012, in the principal amount of \$3,500,000.

Sumter Valley PSA

On April 27, 2012, we entered into a Purchase and Sale Agreement with Pinewood Holdings, LLC to acquire the Sumter Valley Nursing and Rehab Center, a 96-bed skilled nursing facility located in Sumter, South Carolina, for an aggregate purchase price of \$5,500,000. The purchase price consists of: (i) \$5,250,000 cash consideration; and (ii) a \$250,000 promissory note to be issued by AdCare to Pinewood Holdings LLC that shall bear interest at a fixed rate of 6% based on a 15 year amortization schedule. Pursuant to the Purchase and Sale Agreement, we deposited \$100,000 into escrow to be held as earnest money. We expect the closing of the acquisition to occur on July 31, 2012.

Abington Acquisition

On April 30, 2012, we completed the acquisition of Abington Place Health and Rehab Center, a 120-bed skilled nursing facility located in Little Rock, Arkansas from SCLR, LLC, pursuant to that certain previously announced Purchase and Sale Agreement, between SCLR, LLC and AdCare Property Holdings, LLC, dated as of January 3, 2012, for an aggregate purchase price of \$3,600,000. In connection with the closing of this acquisition, APH&R Property Holdings, LLC, our wholly owned subsidiary, entered into a Loan Agreement with Metro City Bank in an aggregate principal amount of \$3,425,500. We will take effective control over operations on June 1, 2012.

The loan matures on September 1, 2012. Interest on the loan accrues on the principal balance thereof at an annual rate of 2.25% per annum plus the prime interest rate, to be adjusted on a monthly basis (but in no event shall the total interest be less than 6.25% per annum), and payments for the interest are payable monthly, commencing on June 1, 2012 and ending on September 1, 2012. The entire outstanding principal balance of the loan, together with all accrued but unpaid interest thereon, is payable on September 1, 2012. The loan is secured by a first mortgage on the real property and improvements constituting the facility. We assigned to Metro City Bank a certificate of deposit in the amount of \$1,000,000 as additional security for the loan.

Convacare

On January 17, 2012, we entered into a Purchase and Sale Agreement with Gyman Properties, LLC to acquire a 141-bed skilled nursing facility located in Lonoke, Arkansas, for an aggregate purchase price of \$6,486,000. Pursuant to the Purchase and Sale Agreement, we deposited \$250,000 into escrow to be held as earnest money. On May 9, 2012, the Company assigned all of its rights under the Purchase and Sale Agreement to GL Nursing, LLC, an entity affiliated with Christopher Brogdon, the Company's Vice Chairman and Chief Acquisition Officer.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

**Special Note Regarding Forward Looking Statements**

Certain statements in this Quarterly Report on Form 10-Q/A (this Quarterly Report) constitute forward-looking statements. These forward-looking statements involve known or unknown risks, uncertainties and other factors that may cause the actual results, performance, or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. This information includes assumptions made by, and information currently available to management, including statements regarding future economic performance and financial condition, liquidity and capital resources, and management's plans and objectives. You can identify forward-looking statements by terminology such as may, will, should, expects, intends, plans, anticipates, estimates, predicts, potential, continues, or the negative of these terms or other comparable terminology. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future developments or otherwise, except as required by applicable laws. You should read this Management's Discussion and Analysis of Financial Condition and Results of Operations in conjunction with the consolidated financial statements and related notes included in this Quarterly Report and in the Annual Report on Form 10-K, as well as other reports that we file with the SEC.

**Change in Accounting for Variable Interest Entities**

As further discussed in Note 19, *Variable Interest Entities*, and Note 21, *Related Party Transactions*, found in the Company's audited consolidated financial statements and notes included in the Company's Annual Report, effective August 1, 2011 entities (the Oklahoma Owners) controlled by Christopher Brogdon and his spouse, Connie Brogdon (related parties to the Company), acquired five skilled nursing facilities located in Oklahoma (the Oklahoma Facilities). The Company entered into a Management Agreement with the Oklahoma Owners pursuant to which a wholly-owned subsidiary of the Company supervises the management of the Oklahoma Facilities for a monthly fee equal to 5% of the monthly gross revenues of the Oklahoma Facilities. Upon acquisition, the Company concluded it was the primary beneficiary of the Oklahoma Owners and pursuant to Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 810-10, *Consolidation - Overall*, consolidated the Oklahoma Owners in its 2011 consolidated financial statements.

During the process of finalizing the 2012 consolidated financial statements, the Company re-assessed its prior conclusion that it should consolidate the Oklahoma Owners. In the reassessment process, the Company concluded that it should not have consolidated the Oklahoma Owners. In the accompanying consolidated financial statements the Company has deconsolidated the Oklahoma Owners effective January 1, 2012 and the balance sheet, operations and cash flows of the Oklahoma Owners are not included in the Company's first quarter 2012 consolidated financial statements. The Company further concluded that including the Oklahoma Owners in its 2011 consolidated financial statements was not material to such consolidated financial statements and therefore no adjustments have been made to the previously issued quarterly and annual 2011 consolidated financial statements.

**Overview**

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The Company owns and manages skilled nursing facilities and assisted living facilities. We deliver skilled nursing, assisted living and home health services through wholly owned separate operating subsidiaries. During the first quarter of 2012, we acquired two facilities (one skilled nursing facility and one assisted living facility), bringing our Company's total bed count to 4,794 at March 31, 2012. The following tables provide summary information regarding our recent acquisitions and facility composition.

	March 31, 2012	December 31, 2011	December 31, 2010
Cumulative number of facilities	52	44(*)	27
Cumulative number of operational beds	4,794	3,916(*)	2,484

(\*) Including the five Oklahoma Facilities which are not consolidated in 2012 as discussed in Note 2. The Oklahoma Facilities included 314 operational beds.

State	Number of Operational Beds/Units	Number of Facilities at March 31, 2012				Total
		Owned	VIE	Leased	Managed for Third Parties	
Arkansas	964	9				9
Alabama	408	2	1			3
Georgia	1,497	3		10		13
Missouri	80			1		1
North Carolina	106	1				1
Ohio	981	10		1	4	15
Oklahoma	758				10	10
<b>Total</b>	<b>4,794</b>	<b>25</b>	<b>1</b>	<b>12</b>	<b>14</b>	<b>52</b>
<b>Facility Type</b>						
Skilled Nursing	4,299	17		12	13	42
Assisted Living	412	8	1			9
Independent Living	83				1	1
<b>Total</b>	<b>4,794</b>	<b>25</b>	<b>1</b>	<b>12</b>	<b>14</b>	<b>52</b>

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*Acquisitions*

We have embarked on a strategy to grow our business through acquisitions and leases of senior care facilities and businesses providing services to those facilities. During the first quarter 2012, we acquired two facilities (one skilled nursing facility and one assisted living facility), bringing our Company's total bed count to 3,602 at March 31, 2012.

- On December 30, 2011, we acquired a skilled nursing facility and an assisted living facility both located in Springfield, Ohio, for an aggregate adjusted purchase price of \$12,412,000.

Subsequent to March 31, 2012, the following acquisitions were completed:

- On April 1, 2012, we acquired three skilled nursing facilities located in Little Rock, Arkansas. The total purchase price was \$27,280,000.

- On April 30, 2012, we acquired a skilled nursing facility located in Little Rock, Arkansas for an aggregate purchase price of \$3,600,000. We will obtain effective control and plan to commence operations on June 1, 2012.

In addition, the following potential acquisitions have been announced during the three months ended March 31, 2012:

- On January 17, 2012, we entered into a Purchase and Sale Agreement with Gyman Properties, LLC to acquire a 141-bed skilled nursing facility located in Lonoke, Arkansas, for an aggregate purchase price of \$6,486,000. Pursuant to the Purchase and Sale Agreement, we deposited \$250,000 into escrow to be held as earnest money. On May 9, 2012, the Company assigned all of its rights under the Purchase and Sale Agreement to GL Nursing, LLC, an entity affiliated with Christopher Brogdon, the Company's Vice Chairman and Chief Acquisition Officer.

- On March 12, 2012, we entered into a Purchase and Sale Agreement with Westlake Nursing Home Limited to acquire a 118-bed skilled nursing facility located in Oklahoma City, Oklahoma, for an aggregate purchase price of \$5,800,000. Pursuant to the Purchase and Sale Agreement, we deposited \$25,000 into escrow to be held as earnest money.

- On March 14, 2012, we entered into a Purchase and Sale Agreement with F & F Ventures, LLC and Tulsa Christian Care, Inc., doing business as Companions Specialized Care Center to acquire a 121-bed skilled nursing facility located in Tulsa, Oklahoma for an aggregate purchase price of \$5,750,000. The purchase price consists of a \$5,000,000 cash payment and the issuance of shares of our common stock with an aggregate value of \$750,000, with such shares valued at the average closing price of our common stock for the ten-day period ending on the



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last business day prior to the closing of the acquisition. Beginning April 1, 2012, we entered into a management agreement to operate the facility in the interim period.

For information regarding purchase and sale agreements of facilities that have been entered into subsequent to March 31, 2012, see Note 16 in the Notes to Consolidated Financial Statements section of Part I, Item 1 of this Quarterly Report.

We are currently evaluating potential acquisition opportunities in addition to those described above and we continue to seek new opportunities to further our growth strategy. No assurance is made that any of these potential acquisition opportunities will be determined to be appropriate for us or that we will complete any of such acquisitions on terms acceptable to us, or at all.

### *Segments*

The Company reports its operations in three segments: Skilled Nursing Facilities ( SNF ), Assisted Living Facilities ( ALF ), and Corporate & Other. The Company delivers services through wholly owned separate operating subsidiaries. The SNF and ALF segments provide services to individuals needing long-term care in a nursing home or assisted living setting and management of those facilities. The Corporate & Other segment engages in the management of facilities and accounting and IT services. We evaluate financial performance and allocate resources primarily based on segment operating income (loss). Segment operating results exclude interest expense and other non-operating income and expenses. See Note 5 in the Notes to Consolidated Financial Statements section of Part I, Item 1 of this Quarterly Report.

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*Skilled Nursing Facilities*

We focus on two primary indicators in evaluating the financial performance in this segment. Those indicators are facility occupancy and patient mix. Facility occupancy is important as higher occupancy generally leads to higher revenues. In addition, concentrating on increasing the number of Medicare covered admissions (the patient mix) helps in increasing revenues. We include commercial insurance covered admissions that are reimbursed at the same level as those covered by Medicare in our Medicare utilization percentages and analysis.

For the three months ended March 31, 2012, revenue in our skilled nursing segment increased by approximately \$14,853,000 compared to March 31, 2011, as a result of acquisitions during the year. This segment had income from operations of \$850,000 as a result of improved quality mix as well as expense control. We expect to continue to implement and refine strategies designed to sustain these goals. Total assets increased by \$4,869,000 due to acquisitions made since March 31, 2011.

Same Facilities results represent those owned and leased facilities we began to operate prior to January 1, 2011.

Recently Acquired Facilities results represents those owned and leased facilities we began to operate subsequent to January 1, 2011.

**Average Occupancy**

	<b>Three Months Ended March 31,</b>	
	<b>2012</b>	<b>2011</b>
Same Facilities	85.9%	86.8%
Recently Acquired Facilities	76.3%	n/a
Total	82.4%	86.8%

We continue our work towards maximizing the number of patients covered by Medicare where our operating margins are higher.

**Patient Mix**

**Three Months Ended March 31,**

	<b>Same Facilities</b>		<b>Recently Acquired Facilities</b>		<b>Total</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
Medicare	15.2%	15.5%	14.3%	n/a	14.9%	15.5%
Medicaid	73.2%	76.4%	71.5%	n/a	72.6%	76.4%

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Other	11.6%	8.1%	14.2%	n/a	12.5%	8.1%
Total	100.0%	100.0%	100.0%	n/a	100.0%	100.0%

For the Three Months Ended March 31, 2012:

State (SNF Only)	Operational Beds at Period End(1)	Period s Average Operational Beds	Occupancy (Operational Beds)	Medicare Utilization (Skilled %ADC)(2)	2012 Q1 Total Revenues	Medicare (Skilled) \$PPD(3)	Medicaid \$PPD(3)
Alabama	304	304	83.7%	12.8%	\$ 4,881	\$ 372.31	\$ 182.77
Arkansas	932	498	70.9%	12.8%	\$ 6,411	\$ 352.68	\$ 171.31
Georgia	1,497	1,497	86.6%	14.7%	\$ 23,690	\$ 456.78	\$ 145.68
Missouri	80	80	61.3%	24.1%	\$ 918	\$ 394.89	\$ 134.01
North Carolina	106	106	89.0%	18.1%	\$ 1,904	\$ 464.29	\$ 154.91
Ohio	293	293	82.9%	17.7%	\$ 5,240	\$ 456.46	\$ 158.76
<b>Total</b>	<b>3,212</b>	<b>2,778</b>	<b>82.4%</b>	<b>14.9%</b>	<b>\$ 43,044</b>	<b>\$ 433.06</b>	<b>\$ 155.22</b>

(1) Excludes managed beds which are not consolidated.

(2) ADC is the Average Daily Census

(3) PPD is the Per Patient Day equivalent

Table of Contents*Assisted Living Facilities*

For the three months ended March 31, 2012, revenue in our ALF segment increased by approximately \$922,000 compared to March 31, 2011 as a result of increased revenue from acquisitions, an annual increase in rates charged to privately paying residents and increasing occupancy. This segment had income from operations of \$684,000. Total assets increased by approximately \$5,061,000 primarily due to acquisitions since March 31, 2011 and other building improvements made during the last 12 months.

	Average Occupancy Three Months Ended March 31,	
	2012	2011
Total	81.4%	74.5%

Residents of our assisted living facilities rely on their personal investments and wealth to pay for their stay. Although many of the risks still remain, such as declines in market values of investments, depressed market for the sale of private homes, and adult children caring for their elderly at home, we have seen an increase in census.

*Corporate & Other*

We manage eight skilled nursing facilities and one independent living campus for third party owners under management agreements that either are for a fixed monthly fee or for a percentage of revenue generated by the managed facility. Depending on the type of management agreement, our revenues increase annually according to inflationary adjustments stipulated in our management agreements or they increase as the facility's revenue increases for the management agreements that are based on a percentage of revenue. This segment includes our corporate overhead expenses, which are made up of salaries of our senior management team members and various other corporate expenses, including, but not limited to, corporate office operating expenses, audit fees, legal fees and board activities. Additionally, non-cash charges for compensation expense related to warrants, restricted stock and stock options are included in corporate overhead. We do not allocate these expenses to the divisions or separate them from management and development business for management review purposes.

*Results of Operations*

Skilled Nursing (Amounts in 000 s)	Total Patient Care Revenues Three Months Ended March 31,	
	2012	2011
Same Facilities	\$ 28,833	\$ 28,191
Recently Acquired Facilities	14,211	n/a
Total	\$ 43,044	\$ 28,191

Assisted Living (Amounts in 000 s)	Three Months Ended March 31,	
	2012	2011
Same Facilities	\$ 2,596	\$ 2,341

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Recently Acquired Facilities		667		n/a
Total	\$	3,263	\$	2,341

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**Comparison for the three months ended March 31, 2012 and 2011**

*Patient Care Revenues* - For the periods presented, total patient care revenues increased by \$15.8 million, or 51%.

Revenue in our SNF segment increased approximately \$14,853,000 when compared to the three months ended March 31, 2011, primarily as a result of additional facilities acquired since March, 2011. In addition, quality mix improved at existing facilities. This segment had income from operations of \$850,000 which is \$345,000 higher compared to the three months ended March 31, 2011 as a result of higher revenue due to acquisitions and improved reimbursement rates. We are seeking to increase facility occupancy and to increase the number of patients covered by Medicare. We seek to continue to implement and refine strategies designed to achieve these goals.

Revenue in our ALF segment increased by approximately \$922,000 when compared to the three months ended March 31, 2011, as a result of increased census and levels of care as well as the addition of one new facility in 2012 and one new facility in the fourth quarter of 2011. This segment had income from operations of \$684,000 which is \$480,000 more than the same period in 2011 from increased occupancy and an annual increase in rates charged to residents of the facilities.

*Management Revenue* - For the periods presented, management revenues (net of eliminations) increased \$26,000, or 5%.

*Cost of Services* - For the periods presented, cost of services was approximately \$38,807,000 compared to \$25,175,000 for the same period a year ago. This is the result of numerous acquisitions over the past 12 months.

*General and Administrative* - For the periods presented, general and administrative costs have increased by \$1,069,000 due to additional management staff necessary to direct the growth and maximize the results of the newly acquired facilities.

**Three Months Ended March 31, 2012**

(Amounts in 000 s)	Same Facilities	Recently Acquired Facilities	Total
SNF Other Operating Expenses	\$ 28,530	\$ 13,664	\$ 42,194
ALF Other Operating Expenses	2,065	514	2,579
Management/Corporate Other Operating Expenses	4,127		4,127
Eliminations	(1,580)	(745)	(2,325)
Total Other Operating Expenses	\$ 33,142	\$ 13,433	\$ 46,575

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*Infrastructure Costs* - Company management separately identifies certain costs, which the Company has incurred that we believe are directly related to the growth of the Company. These infrastructure costs include, but are not limited to, additional management and staff necessary to support our operational teams in our newly acquired facilities, including those in states that we have not previously operated in. These costs are included in the consolidated statement of operations (included elsewhere in this Quarterly Report) under General and Administrative Expenses. Infrastructure costs were approximately \$159,000 and \$117,000 for the three months ended March 31, 2012 and 2011, respectively.

*Facility Rent Expense* - For the periods presented, lease expenses increased by \$162,000 due to annual increases in rental rates and the addition of the one new leased facility in the fourth quarter of 2011.

(Amounts in 000 s)	Three Months Ended March 31	
	2012	2011
Lease Expense	\$ 2,065	\$ 1,903

*Depreciation and Amortization* - For the periods presented, depreciation and amortization increased by \$1,063,000. The depreciation increase is directly related to acquisition activity that was not included in the 2011 results as it occurred in later periods and a \$389,000 impairment charge recognized by the Company on an office building located in Rogers, Arkansas.

*Interest Expense, net* - For the periods presented, interest expense, net increased by \$1,242,000, or 86%. We have entered into numerous debt instruments in relation to our growth strategy for the acquisition of the facilities which began in the third quarter of 2010. In addition, several of the arrangements are short term in nature resulting in higher interest rates than previously experienced and an increase in the amortization of deferred loan costs associated with the new debt agreements.

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*Acquisition Costs, net of Gains* - For the period ended March 31, 2012, acquisition costs, net of gains was an expense of \$293,000, compared to a net gain of \$979,000 for the comparative period. For the period ended March 31, 2012, the total acquisition costs were legal fees directly related to the acquisition of the two Ohio facilities and other costs incurred on potential future acquisitions. For the period ended March 31, 2011, the amount was the result of gains recognized on the acquisition of the Sylva, North Carolina facility during the first quarter of 2011.

*Derivative Gain/Loss* - For the period ended March 31, 2012, the derivative gain was \$410,000, compared to a loss of \$1,350,000 for the same period in 2011. The derivative is a product of a convertible debt instrument entered into during the third quarter of 2010. The expense associated with the derivative increases as the stock price climbs, and conversely decreases as the stock price declines. The price of the common stock of the Company declined during the three-month period ended March 31, 2012.

*Other Income/(Expense)* - For the periods presented, other income decreased by \$620,000. There was a recovery of receivables recorded in the prior year which did not occur in the three months ended March 31, 2012.



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**Critical Accounting Policies and Use of Estimates**

Except for the re-assessment of our application of FASB ASC Topic 810, *Consolidation - Overall*, related to the Oklahoma Owners, there have been no significant changes during the three months ended March 31, 2012 to the items that we disclosed as our critical accounting policies and use of estimates in our discussion and analysis of financial condition and results of operation contained in the Annual Report.

As further discussed in Note 19, *Variable Interest Entities*, and Note 21, *Related Party Transactions*, found in the Company's audited consolidated financial statements and notes included in the Company's Annual Report, effective August 1, 2011 entities (the Oklahoma Owners) controlled by Christopher Brogdon and his spouse, Connie Brogdon (related parties to the Company), acquired five skilled nursing facilities located in Oklahoma (the Oklahoma Facilities). The Company entered into a Management Agreement with the Oklahoma Owners pursuant to which a wholly-owned subsidiary of the Company supervises the management of the Oklahoma Facilities for a monthly fee equal to 5% of the monthly gross revenues of the Oklahoma Facilities. Upon acquisition, the Company concluded it was the primary beneficiary of the Oklahoma Owners and pursuant to FASB ASC Topic 810, *Consolidation - Overall*, consolidated the Oklahoma Owners in its 2011 consolidated financial statements.

During the process of finalizing the 2012 consolidated financial statements, the Company re-assessed its prior conclusion that it should consolidate the Oklahoma Owners. In the reassessment process, the Company concluded that it should not have consolidated the Oklahoma Owners. In the accompanying consolidated financial statements the Company has deconsolidated the Oklahoma Owners effective January 1, 2012 and the balance sheet, operations and cash flows of the Oklahoma Owners are not included in the Company's first quarter 2012 consolidated financial statements. The Company further concluded that including the Oklahoma Owners in its 2011 consolidated financial statements was not material to such consolidated financial statements and therefore no adjustments have been made to the previously issued quarterly and annual 2011 consolidated financial statements.

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**Liquidity and Capital Resources**

*Overview*

Liquidity is the measure of the Company's ability to have adequate cash or access to cash at all times in order to meet financial obligations when due, as well as to fund corporate expansion and other activities. Historically, the Company has met its liquidity requirements through a combination of net cash flow from operations, debt from third party lenders and issuances of other debt and equity securities.

We have negative working capital of approximately \$8,119,000 at March 31, 2012. Our ability to sustain profitable operations is dependent on continued growth in revenue and controlling costs.

During the next twelve months, the Company believes it will require additional financing to satisfy its financial obligations and implement its expansion strategy. The Company is currently exploring several financing alternatives and may seek to raise additional capital through the sale of additional debt or equity securities, although there is no assurance that the Company will be able to raise additional capital through the issuance of debt or equity securities on terms acceptable to it, or at all. If the Company is unable to secure such additional financing, then the Company may be required to restructure its outstanding indebtedness and delay or modify its expansion plans.

Eaglewood Facilities Financing

On January 1, 2012, Woodland Holdings, LLC, our wholly owned subsidiary, entered into a loan agreement with The PrivateBank and Trust Company in an aggregate principal amount of \$4,800,000. The loan was used to fund the acquisition of the Woodland Manor facility located in Springfield, Ohio.

The loan matures on December 30, 2016. Interest on the loan accrues on the principal balance thereof at an annual rate of the greater of (i) 6.0% per annum or (ii) the LIBOR rate plus 4.0% per annum, and payments for the interest and a portion of the principal balance are payable monthly, commencing on February 1, 2012 and ending on December 1, 2016. The entire outstanding principal balance of the loan, together with all accrued but unpaid interest thereon, is payable on December 30, 2016. The loan is secured by a first mortgage on the real property and improvements constituting the Woodland Manor facility and guaranteed by AdCare.

In addition, on January 1, 2012, Eaglewood Holdings, LLC and Eaglewood Village, LLC, our wholly owned subsidiaries, jointly and severally issued two promissory notes to Eaglewood Villa, Ltd. in the amount of \$4,500,000 and \$500,000. Proceeds from the notes were used to fund the acquisition of the Eaglewood Village facility located in Springfield, Ohio.

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The \$500,000 note matures on December 30, 2016 and the \$4,500,000 note matures on June 30, 2012. Interest on the \$500,000 note accrues at a rate of 6.5% per annum and interest on the \$4,500,000 Eaglewood Loan accrues at a rate of (i) 6.5% per annum from January 1, 2012 to February 29, 2012; (ii) 8.5% per annum from March 1, 2012 to April 30, 2012; and (iii) 10.5% per annum from May 1, 2012 to June 30, 2012. Principal and interest payments under the notes shall be due and payable monthly, beginning on February 1, 2012. The notes are secured by a mortgage on the real property and improvements constituting the Eaglewood Village facility.

### HUD Financing

On January 31, 2012, we refinanced the mortgage on our Home & Hearth of Vandalia facility to obtain a term note guaranteed by HUD. The HUD mortgage note requires monthly principal and interest payments with an annual fixed interest rate of 3.74%. The note matures in 2041. The note has a prepayment penalty of 8% for any prepayment made prior to March 1, 2014, which penalty is reduced by 1% each year thereafter until the eighth anniversary of such date, after which there is no prepayment penalty.

### Cantone Promissory Note March 2012

On March 29, 2012, we issued a promissory note in favor of Cantone Asset Management LLC for an aggregate principal amount of \$3,500,000. The note matures on the earlier of: (i) October 1, 2012; or (ii) the date on which we shall receive proceeds, in an amount not less than \$6,000,000, from a public offering or private placement of our common stock. Interest on the note accrues on the principal balance thereof at an annual rate of 10%; provided, however, if the entire principal amount of the note is not paid by July 1, 2012, the interest rate shall increase by 1% for each month or part thereof during which any principal amount of the note shall remain

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unpaid. We may prepay the note in whole or in part, at any time, without notice or penalty; provided, however, if the note is prepaid prior to October 1, 2012, then we shall continue to pay interest on the note through such date.

In connection with the issuance of the note, Cantone Research, Inc. has agreed to provide us with certain consulting services for a monthly fee if the Company and Cantone Asset Management LLC (or an affiliated entity) do not agree to the terms of an additional financing arrangement pursuant to which it (or affiliated entity) would loan to us at least \$4,000,000 for a four-year term.

2012 Public Stock Offering

In March 2012, we completed a firm commitment underwritten public offering of 1,100,000 shares of our common stock at a public offering price of \$3.75 per share. We received net proceeds of approximately \$3.6 million after deducting underwriting discounts, and other offering-related expenses of approximately \$0.5 million. We intend to use the net proceeds from this offering for working capital and other general corporate purposes.

The Company has also granted the underwriters in the offering an option for 45 days to purchase an additional 165,000 shares of common stock to cover over-allotments, if any. This over-allotment option expires on May 11, 2012.

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For information on financings that have been entered into subsequent to March 31, 2012, see Note 16 in the Notes to Consolidated Financial Statements section of Part I, Item 1 of this Quarterly Report.

The following table presents selected data from our consolidated statement of cash flows for the periods presented (*in thousands*):

	<b>Three Months Ended March 31</b>	
	<b>2012</b>	
	<b>As Restated</b>	<b>2011</b>
	<b>(Note 2)</b>	
Net cash provided by operating activities - continuing operations	\$ 1,607	\$ 623
Net cash (used in) provided by operating activities - discontinued operations	(105)	160
Net cash used in investing activities - continuing operations	(7,813)	(5,490)
Net cash provided by financing activities - continuing operations	10,175	10,546
Net cash used in financing activities - discontinued operations	(48)	(46)
Net change in cash and cash equivalents	3,816	5,793
Cash and cash equivalents at beginning of period	7,364	3,911
Cash decrease due to deconsolidation of variable interest entities	(180)	
Cash and cash equivalents at end of period	\$ 11,000	\$ 9,704

*Three months ended March 31, 2012*

Net cash provided by operating activities for the three months ended March 31, 2012, was approximately \$1,502,000 consisting primarily of our net loss and changes in working capital, offset by noncash charges (primarily depreciation and amortization, share-based compensation, difference between straight-line rent and rent paid, and amortization of debt discounts and related deferred financing costs); all primarily the result of routine operating activity.

Net cash used in investing activities for the three months ended March 31, 2012, was approximately \$7,813,000. This is primarily the result of funding our acquisitions, including making escrow deposits and purchase of property and equipment.

Net cash provided by financing activities was approximately \$10,127,000 for the three months ended March 31, 2012. This is primarily the result of cash proceeds received from warrant exercises, the public stock offering, and proceeds from debt financings to fund our acquisitions, partially offset by repayments of existing debt obligations.

*Three months ended March 31, 2011*

Net cash used in operating activities for the three months ended March 31, 2011 was approximately \$783,000 consisting primarily of our net loss from operations and changes in working capital partially offset by noncash charges, all primarily the result of routine operating activity.

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Net cash used in investing activities for the three months ended March 31, 2011 was approximately \$5,490,000. This is primarily the result of deposits for acquisitions and the purchase of additional equipment offset partially by reductions in restricted cash and investments.

Net cash provided by financing activities was approximately \$10,500,000 for the three months ended March 31, 2011. This is primarily the result of proceeds from the convertible debt issuance net of issuance costs on March 31, 2011, and increases in borrowings on the line of credit partially offset by repayments of existing debt obligations.

### *Debt Covenant Compliance*

As of March 31, 2012, the Company (including its consolidated variable interest entity) had 26 different credit facilities (credit facilities, mortgage notes, bonds and other credit obligations) outstanding that include various financial and administrative covenant requirements. Covenant requirements include, but are not limited to, fixed charge coverage ratios, debt service coverage ratios, minimum EBITDA or EBITDAR, current ratios and tangible net worth requirements. Certain financial covenant requirements are based on consolidated financial measurements whereas others are based on subsidiary level (i.e., facility, multiple facilities or a combination of subsidiaries comprising less than the Company's consolidated financial measurements). Some covenants are based on annual financial metric measurements whereas others are based on monthly or quarterly financial metric measurements. The Company routinely tracks and monitors its compliance with its covenant requirements. In recent periods, including as of March 31, 2012, the Company has not been in compliance with certain financial and administrative covenants. For each instance of such non-compliance, the Company has obtained waivers or amendments to such requirements, including, as necessary, modifications to future covenant requirements or the elimination of certain requirements in future periods.

The following table includes financial covenant requirements as of the last measurement date as of or prior to March 31, 2012 where the Company was not in compliance with the financial covenant or it achieved compliance with the covenant requirement by a margin of 10% or less. The table also identifies the related credit facility, outstanding balance at March 31, 2012 and the next applicable future financial covenant requirement inclusive of adjustments to covenant requirements resulting from amendments executed subsequent to March 31, 2012.

Period Ended	Balance at March 31, 2012 (000 s)	Consolidated or Subsidiary Level Covenant Requirement	Financial Covenant	Measurement Period	Min/Max Financial Covenant Required	March 31, 2012	
						As Reported Financial Covenant Metric Achieved	As Restated Financial Covenant Metric Achieved
Gemino - Line of Credit	\$ 6,717	Consolidated	Fixed Charge Coverage Ratio (FCCR)	Quarterly	1.10	0.53	3.49*
PrivateBank - Line of Credit (Bentonville LOC)	\$ 1,308	Subsidiary	FCCR	Quarterly	1.05	2.16	0.89*
PrivateBank - Mortgage Note - Homestead, Valley River, Bentonville	\$ 11,678	Subsidiary Consolidated	EBITDAR(000 s) DSCR	Quarterly Annual	\$ 450 n/a	\$ 702 n/a	\$ -4* n/a
Square 1 USDA - Term Note - Homestead	\$ 3,578	Subsidiary Subsidiary	Current ratio Maximum debt to net worth	Quarterly Quarterly	1.00 9.00	0.37 7.57	0.27* 14.34*
PrivateBank - Mortgage Note - Woodland Manor	\$ 4,783	Subsidiary Subsidiary	Tangible net worth Minimum quarterly EBITDAR (000 s)	Quarterly Quarterly	10.0% \$ 250	11.7% \$ 301	6.5%* \$ 280
		Subsidiary	Minimum trailing twelve month FCCR	Quarterly	1.10	1.83	1.92

\* Waiver or amendment for violation of covenant obtained.

**Item 4. Controls and Procedures**

As previously disclosed, the Audit Committee, in consultation with management, concluded in March 2013 that: (i) the Company's previously issued financial statements for the quarters ended March 31, 2012, June 30, 2012 and September 30, 2012 (the Relevant Financial Statements ) should no longer be relied upon due to errors in the Relevant Financial Statements identified in connection with the audit of the Company's consolidated financial statements for the year ended December 31, 2012; and (ii) the Company would restate the Relevant Financial Statements.

The Audit Committee initiated a further review of, and inquiry with respect to, the accounting and financial issues related to these and other potential errors and engaged counsel to assist the Audit Committee with such matters. The Audit Committee completed its

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inquiry and, in connection therewith, assisted in the correction of certain errors relating to accounting and financial matters and identified certain material weaknesses in the Company's internal control over financial reporting, including weakness in the Company's ability to appropriately account for complex or non-routine transactions and in the quality and sufficiency of the Company's finance and accounting resources.

On July 8, 2013, the Company restated the Relevant Financial Statements by filing with the SEC amendments to its Quarterly Reports on Form 10-Q for the quarters ended March 31, 2012, June 30, 2012 and September 30, 2012.

***Evaluation of Disclosure Controls and Procedures***

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed pursuant to the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Our Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this Quarterly Report (the Evaluation Date). Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the Evaluation Date, our disclosure controls and procedures were not effective.

***Management's Report on Internal Control Over Financial Reporting***

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act). Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes policies and procedures that are intended to:

- (1) maintain records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;
- (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. GAAP, and that our receipts and expenditures are being made only in accordance with the authorization of our management and directors; and



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(3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate due to changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. A control system, no matter how well designed and operated, can provide only reasonable, but not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefit of controls must be considered relative to their costs.

Management evaluated the effectiveness of our internal control over financial reporting as of December 31, 2012. In making this evaluation, management used the framework and criteria set forth in the report entitled *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ( COSO ). The COSO framework summarizes each of the components of a company's internal control system, including: (i) the control environment, (ii) risk assessment, (iii) control activities, (iv) information and communication and (v) monitoring.

Consistent with the results of the Audit Committee's review and inquiry, management identified material weaknesses in the Company's ability to appropriately account for complex or non-routine transactions and the quality and sufficiency of the Company's finance and accounting resources in relation to the increasing complexity and growth of the Company's operations.

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As a result of the material weaknesses described above, management has concluded that our internal control over financial reporting was not effective at December 31, 2012 based on the guidelines established in Internal Control – Integrated Framework issued by COSO.

***Changes in Internal Control over Financial Reporting and Remediation***

In response to the material weaknesses in the Company's internal control over financial reporting, and based in part on recommendations made by the Audit Committee to the Board of Directors following the completion of the Audit Committee's review and inquiry, we have implemented, or plan to implement, the changes to our internal control over financial reporting discussed below.

- We hired Ronald W. Fleming to serve as Chief Financial Officer of the Company effective May 15, 2013. Mr. Fleming has relevant industry experience as well as experience with generally accepted accounting principles and SEC reporting and compliance.
- We have empowered Mr. Fleming to hire additional accounting and finance staff to ensure adequate internal control over financial reporting and operations.
- We are seeking to hire a permanent Chief Accounting Officer, as further discussed below.
- We have expanded the scope of our annual internal audit plan to include quarterly internal audit procedures with emphasis on the review of journal entries and non-recurring transactions.

In April 2013, we engaged an Interim Chief Accounting Officer on a contract basis. We are currently discussing with our Interim Chief Accounting regarding the terms of her employment as the Company's Chief Accounting Officer and believe that we will reach agreement on such terms in the near term.

Since January 2013, the Company has hired eight new finance and accounting personnel, including a Vice President of Facility Accounting Operations. Our new finance and accounting leadership continue to evaluate the qualifications and sufficiency of our accounting and finance department. The expanded internal audit scope has commenced and will be completed prior to the Company filing its Quarterly Reports on Form 10-Q for each of the 2013 quarterly periods.

Due to the short time period since we commenced our efforts to remediate our material weaknesses, and because we have not fully completed our financial reporting process for the quarter ended March 31, 2013, we have not yet been able to fully evaluate the effectiveness of such efforts. We have incurred, and will continue to incur, additional incremental costs associated with our remediation efforts, primarily due to hiring new finance and accounting personnel and external consultants and the implementation and validation of improved accounting and financial reporting procedures. If we are not successful in remediating our material weaknesses, or if we determine in future fiscal periods that

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we have additional material weaknesses in our internal control over financial reporting, then the reliability of our financial reports may be adversely impacted, we may be unable to file our reports with the SEC in a timely fashion and we could be required to restate our financial results. This could cause our investors to lose confidence in our financial reporting, which could adversely affect the trading price of our stock.

Other than the remediation efforts discussed above, which occurred in 2013 and have included the involvement of our new finance and accounting leadership in the preparation, review, and approval of the consolidated financial statements included in this Quarterly Report, there have not been any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) since January 1, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

In addition, there were not any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the first quarter of 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**Part II. Other Information**

Item 6. Exhibits

The agreements included as exhibits to this Quarterly Report are included to provide information regarding the terms of these agreements and are not intended to provide any other factual or disclosure information about the Company, its business or the other parties to these agreements. These agreements may contain representations and warranties by each of the parties to the applicable agreement. These representations and warranties have been made solely for the benefit of the other parties to the applicable agreement and:

- should not in all instances be treated as categorical statements of fact, but rather as a way of allocating the risk to one of the parties if those statements prove to be inaccurate;

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- have been qualified by disclosures that were made to the other party in connection with the negotiation of the applicable agreement, which disclosures are not necessarily reflected in the agreement;
  
- may apply standards of materiality in a way that is different from what may be viewed as material to investors; and
  
- were made only as of the date of the applicable agreement or such other date or dates as may be specified in the agreement and are subject to more recent developments.

Accordingly, these representations and warranties may not describe the actual state of affairs as of the date they were made or at any other time, and should not be relied upon by investors.

Exhibit No.	Description	Method of Filing
2.1	Purchase and Sale Agreement, dated as of January 3, 2012, between SCLR, LLC and AdCare Property Holdings, LLC	Incorporated by reference from Exhibit 2.9 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2011
2.2	Purchase and Sale Agreement, dated as of January 17, 2012, between Gyman Properties, LLC and AdCare Property Holdings, LLC	Incorporated by reference from Exhibit 2.1 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2011
2.3	Purchase and Sale Agreement, dated March 12, 2012, by and between Westlake Nursing Home Limited and AdCare Property Holdings, LLC	Incorporated by reference from Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed March 15, 2012
2.4	Purchase and Sale Agreement, dated March 14, 2012, by and between F & F Ventures, LLC, Tulsa Christian Care, Inc., d/b/a/ Companions Specialized Care Center and AdCare Property Holdings, LLC	Incorporated by reference from Exhibit 2.2 to the Registrant's Current Report on Form 8-K filed March 15, 2012
2.5	Purchase and Sale Agreement, dated as of April 3, 2012, between Evans Memorial Hospital, Inc. and AdCare Property Holdings, LLC.	Incorporated by reference from Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed April 9, 2012
2.6	Third Amendment to Purchase and Sale Agreement, dated as of April 17, 2012, by and between First Commercial Bank and AdCare Property Holdings, LLC.	Incorporated by reference from Exhibit 2.2 to the Registrant's Current Report on Form 8-K filed April 23, 2012
2.7	Purchase Agreement, dated as of April 27, 2012, between AdCare Property Holdings, LLC and Pinewood Holdings, LLC	Incorporated by reference from Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed May 3, 2012
2.8	Second Amendment to Purchase and Sale Agreement, dated April 30, 2012, by and between Gyman Properties, LLC and AdCare Property Holdings, LLC	Incorporated by reference from Exhibit 2.2 to the Registrant's Current Report on Form 8-K filed May 3, 2012
3.1	Amended and Restated Articles of Incorporation	

Incorporated by reference from Exhibit 3.1 of the  
Registrant's Registration Statement Form SB  
(Registration No. 333-131542)

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Exhibit No.	Description	Method of Filing
		filed February 3, 2006
3.2	Code of Regulations	Incorporated by reference from Exhibit 3.2 of the Registrant's Registration Statement Form SB (Registration No. 333-131542) filed February 3, 2006
3.3	Amendment to Amended and Restated Articles of Incorporation	Incorporated by reference to Exhibit 3.3 of the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2011
4.1	Warrant to Purchase 312,500 Shares of Common Stock, dated April 1, 2012, issued by AdCare Health Systems, Inc. to Strome Alpha Offshore Ltd.	Previously filed
4.2	Warrant to Purchase 300,000 Shares of Common Stock, dated March 30, 2012, issued by AdCare Health Systems, Inc. to Cantone Asset Management LLC	Previously filed
10.1	Mortgage Deed, recorded January 31, 2012, executed by Hearth and Home of Vandalia, Inc. in favor of Red Mortgage Capital, LLC	Previously filed
10.2	Mortgage Note, dated January 1, 2012, entered into by Hearth & Home of Vandalia, Inc. in favor of Red Mortgage Capital, LLC	Previously filed
10.3	Security Agreement, dated January 1, 2012, by and between Hearth and Home of Vandalia, Inc. and Red Mortgage Capital, LLC	Previously filed
10.4	Lessee Security Agreement, dated January 1, 2012, by and among AdCare Health Systems, Inc., Hearth & Home of Vandalia, Inc. and Red Mortgage Capital, LLC	Previously filed
10.5	Modification Agreement, dated as of March 9, 2012, by and among Benton Nursing, LLC, Park Heritage Nursing, LLC, Valley River Nursing, LLC, Homestead Nursing, LLC, Woodland Manor Nursing, LLC, Mountain View Nursing, LLC, AdCare Health Systems, Inc. and the PrivateBank and Trust Company	Incorporated by reference from Exhibit 99.2 to the Registrant's Current Report on Form 8-K filed March 15, 2012
10.6	Loan Agreement, dated as of March 30, 2012, by and among Little Rock HC&R Property Holdings, LLC, Northridge HC&R Property Holdings, LLC, Woodland Hills HC Property Holdings, LLC and The PrivateBank and Trust Company	Previously filed
10.7	Promissory Note, dated as of March 30, 2012, issued by Little Rock HC&R Property Holdings, LLC, Northridge HC&R Property Holdings, LLC and Woodland Hills HC Property Holdings, LLC in favor of The PrivateBank and Trust Company in the amount of \$21,800,000	Previously filed

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Exhibit No.	Description	Method of Filing
10.8	Promissory Note, dated April 1, 2012, issued by AdCare Health Systems, Inc. in favor of Strome Alpha Offshore Ltd., in the amount of \$5,000,000	Previously filed
10.9	Promissory Note, dated March 30, 2012, issued by AdCare Health Systems, Inc. in favor of Cantone Asset Management LLC, in the amount of \$3,500,000	Previously filed
10.10	Note Purchase Agreement, dated March 29, 2012, by and between AdCare Health Systems, Inc. and Cantone Asset Management LLC	Previously filed
10.11	Guaranty of Payment and Performance, dated as of March 30, 2012, made by AdCare Health Systems, Inc., Little Rock HC&R Property Holdings, LLC, Northridge HC&R Property Holdings, LLC and Woodland Hills HC Property Holdings, LLC, to and for the benefit of The PrivateBank and Trust Company	Previously filed
10.12	Mortgage, Security Agreement, Assignment of Rents and Leases & Fixture Filing, dated as of April 1, 2012, executed by Little Rock HC&R Property Holdings, LLC to and for the benefit of The PrivateBank and Trust Company	Previously filed
10.13	Mortgage, Security Agreement, Assignment of Rents and Leases & Fixture Filing, dated as of April 1, 2012, executed by Northridge HC&R Property Holdings, LLC to and for the benefit of The PrivateBank and Trust Company	Previously filed
10.14	Mortgage, Security Agreement, Assignment of Rents and Leases & Fixture Filing, dated as of April 1, 2012, executed by Woodland Hills HC Property Holdings, LLC to and for the benefit of The PrivateBank and Trust Company	Previously filed
10.15	Absolute Assignment of Rents and Leases, dated as of April 1, 2012, executed by Little Rock HC&R Property Holdings, LLC to and for the benefit of The PrivateBank and Trust Company	Previously filed
10.16	Absolute Assignment of Rents and Leases, dated as of April 1, 2012, executed by Northridge HC&R Property Holdings, LLC to and for the benefit of The PrivateBank and Trust Company	Previously filed
10.17	Absolute Assignment of Rents and Leases, dated as of April 1, 2012, executed by Woodland Hills HC Property Holdings, LLC to and for the benefit of The PrivateBank and Trust Company	Previously filed
10.18	Loan Agreement, dated as of April 12, 2012, between the City of Springfield, Ohio and Eaglewood Property Holdings, LLC	Previously filed
10.19	Guaranty Agreement, dated as of April 12, 2012, made and entered into by AdCare Health Systems, Inc., to and for the benefit of BOKF, NA dba Bank of Oklahoma	Previously filed



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Exhibit No.	Description	Method of Filing
10.20	Land Use Restriction Agreement, dated as of April 12, 2012, by and between BOKF, NA dba Bank of Oklahoma and Eaglewood Property Holdings, LLC	Previously filed
10.21	Open-End Mortgage, Assignment of Leases and Security Agreement, dated April 12, 2012, from Eaglewood Property Holdings, LLC to BOKF, NA dba Bank of Oklahoma	Previously filed
10.22	Loan Agreement, dated April 30, 2012, by and between APH&R Property Holdings, LLC and Metro City Bank	Incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K filed May 3, 2012
10.23	Promissory Note, dated April 30, 2012, issued by APH&R Property Holdings, LLC in favor of Metro City Bank in the amount of \$3,425,500	Incorporated by reference from Exhibit 99.2 to the Registrant's Current Report on Form 8-K filed May 3, 2012
10.24	Mortgage and Security Agreement, dated April 30, 2012, between APH&R Property Holdings, LLC and Metro City Bank	Incorporated by reference from Exhibit 99.3 to the Registrant's Current Report on Form 8-K filed May 3, 2012
10.25	Security Agreement, dated April 30, 2012, between APH&R Property Holdings, LLC and Metro City Bank	Incorporated by reference from Exhibit 99.4 to the Registrant's Current Report on Form 8-K filed May 3, 2012
10.26	Guaranty, dated as of April 30, 2012, between APH&R Property Holdings, LLC in favor of Metro City Bank	Incorporated by reference from Exhibit 99.5 to the Registrant's Current Report on Form 8-K filed May 3, 2012
10.27	Guaranty, dated as of April 30, 2012, between AdCare Health Systems, Inc. in favor of Metro City Bank	Incorporated by reference from Exhibit 99.6 to the Registrant's Current Report on Form 8-K filed May 3, 2012
10.28	Collateral Assignment of Certificate of Deposit, dated April 30, 2012, by and between APH&R Property Holdings, LLC and Metro City Bank	Incorporated by reference from Exhibit 99.7 to the Registrant's Current Report on Form 8-K filed May 3, 2012
10.29	Promissory Note, dated April 27, 2012, issued by Cantone Asset Management LLC in favor of AdCare Health Systems, Inc. in the amount of \$1,500,000	Incorporated by reference from Exhibit 99.8 to the Registrant's Current Report on Form 8-K filed May 3, 2012
10.30	Assignment of Purchase and Sale Agreement, dated May 9, 2012, between AdCare Property Holdings, LLC and GL Nursing, LLC	Previously filed
31.1	Certification of CEO pursuant to Section 302 of the Sarbanes-Oxley Act.	Filed herewith
31.2	Certification of CFO pursuant to Section 302 of the Sarbanes-Oxley Act	Filed herewith
32.1	Certification of CEO pursuant to Section 906 of the Sarbanes-	Filed herewith

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Exhibit No.	Description	Method of Filing
	Oxley Act	
32.2	Certification of CFO pursuant to Section 906 of the Sarbanes-Oxley Act	Filed herewith
101	The following financial information from AdCare Health Systems, Inc. Quarterly Report on Form 10-Q for the quarter ended March, 2012, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Statements of Operations for the three ended March 31, 2012 and 2011, (ii) Consolidated Balance Sheets as of March 31, 2012 and December 31, 2011, (iii) Consolidated Statements of Cash Flows for the three months ended March 31, 2012 and 2011, (iv) Consolidated Statements of Stockholders Equity for the three months ended March 31, 2012 and (i) the Notes to Consolidated Financial Statements.	Filed herewith

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this amendment to be signed on its behalf by the undersigned, thereunto duly authorized.

**ADCARE HEALTH SYSTEMS, INC.  
(Registrant)**

Date: October 22, 2013

/s/ Boyd P. Gentry  
Boyd P. Gentry  
Chief Executive Officer  
(Principal Executive Officer)

Date: October 22, 2013

/s/ Ronald W. Fleming  
Ronald W. Fleming  
Chief Financial Officer  
(Principal Financial and Accounting Officer)